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A Framework for Reforming the South African Law of Security Rights in Movable Property

by

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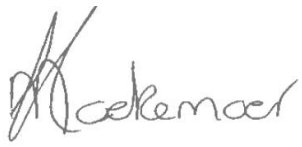
Signature of student: 

SUMMARY

It is relatively clear why the South African legal framework governing security rights in movable property should be reformed; the current framework is outdated and both legally and commercially ineffective. In this light, the study evaluates the legal efficacy of the current South African legal framework governing security rights in movable property – ie, pledges, notarial bonds, and title-based security devices (a *quasi*-security) – against selected legal frameworks. The frameworks used to benchmark the South African framework, are published by the United Nations Commission on International Trade Law, the European Bank for Reconstruction and Development, and the Organization of American States.

A vertical comparative approach (the approach followed in this study) is possible where common denominators – here key policy objectives and fundamental principles – are sufficiently similar to justify comparison between the frameworks selected. The point of departure is to establish and give content to the key policy objectives and fundamental principles (policies) of each framework, and to consider their interrelationship. The key policy objectives provide the general policy context. The comprehensive fundamental principle(s) are then tailored to realise the key policy objective(s) while bearing in mind what is fit-to-context for the reforming country. The aspects of a secured-transactions-law framework, primarily included as part of key policy objectives and fundamental principles and which influence reform, include: (1) whether to implement a unitary, non-unitary, or commercially-facilitative approach in order to establish a single legal framework for security rights in movable property; (2) whether the method used to create *and* allow the third-party effect of the security right should change (should there be a security right that initially only apply *inter partes*); (3) how comprehensive (or inclusive) the scope of a legally and commercially relevant legal framework should be; (4) what the preferred publicity method should be which, while ensuring transparency still results in legal certainty and remains a logical commercial choice; (5) how to develop transparent and predictable priority rules; (6) how to adopt effective enforcement measures; and (7) the extent to which different types of creditors should be treated equally by the law (focusing on the application of acquisition financing).

The outcome of the study presents a robust framework, pivoting on key policy objectives and fundamental principles which the South African legislature and policymakers need to consider to establish a legally efficient framework for secured transactions law reform in South Africa.

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LIST OF ABBREVIATIONS AND COMMON TERMS[1]

ADB	Asian Development Bank
CILSA	Comparative and International Law Journal of Southern Africa
DCFR	Draft Common Frame of Reference
EBRD	European Bank for Reconstruction and Development
EBRD Model Law	EBRD Model Law on Secured Transactions
JBL	Juta's Business Law
NCA	National Credit Act 34 of 2005
OAS	Organization of American States
OAS Model Law	Model Inter-American Law on Secured Transactions
OHADA	*Organisation pour l' Harmonisation en Afrique due Droit des Affaires* (French translation of the Organisation for the Harmonisation of Business Law in Africa)
PMSI	Purchase money security interest
PPSA	Personal Property Securities Act (applicable to statutes from different legal jurisdictions)
SMPA	Security by Means of Movable Property Act 57 of 1993
SA Merc LJ	South African Mercantile Law Journal
SALJ	South African Law Journal
Stell L Rev	Stellenbosch Law Review
THRHR	Tydskrif vir Hedendaagse Romeins-Hollandse Reg
TSAR	Tydskrif vir die Suid-Afrikaanse Reg
UCC	Uniform Commercial Code of the United States of America

[1] The abbreviations for all South African law journals are provided in this list. Foreign legal periodicals are referred to in full as part of the bibliography, but the abbreviation is used in the footnotes.

UNCITRAL	United Nations Commission on International Trade Law
UNCITRAL Guide	UNCITRAL Legislative Guide on Secured Transactions
UNCITRAL Model Law	UNCITRAL Model Law on Secured Transactions
UNIDROIT	International Institute for the Unification of Private Law

TABLE OF CONTENTS

CHAPTER 1
INTRODUCTION

1.1 Introduction and contextual foundation of the problem statement

The South African real security law framework in respect of movable property is effectively still a Roman law framework, albeit for the introduction of notarial bonds almost three decades ago.[1] This lack of reform is a cause for concern in that the current legal framework will of necessity be outdated and unresponsive to what modern commerce requires of a legal framework – inevitably resulting in an ineffective legal framework. South Africa's lack of legal reform stands in sharp contrast to global trends which have seen an upsurge in moves to reform the legal frameworks for security rights. Consequently, the purpose of this research is to establish to what extent the current South African legal framework governing security rights in corporeal movable property needs to be reformed to make it effective.[2]

Determining whether this framework is effective requires measuring the *legal* efficacy of the current legal framework governing security rights in movable property. An enquiry into the *legal* efficacy of a real security law framework hinges on determining: (1) whether the existing framework achieves its primary legal function; and (2) whether the current framework delivers an economic benefit, or put simply, whether this framework is commercially relevant.[3] It is my submission that the primary legal function of a legal framework for security rights in movable property is to ensure that a secured creditor holds adequate and enforceable security in the *encumbered property* of the debtor. Consequently, a secured creditor should have access to the debtor's encumbered movable property when the debtor defaults. In turn, the security will qualify as 'adequate and enforceable' where, in the event of default, the creditor can either

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1 See the South African Law Commission Report (Project 46) 'Report on the giving of security by means of movable property' (1991) (SALC report) as the previous project on law reform in this regard. The name of the South African Law Commission was changed to the South African Law Reform Commission in terms of ss 8 and 9 of the Judicial Matters Amendment Act 55 of 2002 subsequent to this report. However, further reference to this report refers to the former name of the commission.

2 This study focuses on corporeal movable property. However, to be comprehensive, Chapter 2 includes mention of the transfer of specific incorporeal movable property using cession *in securitatem debiti*. Chapters 3 and 4 also include reference to a security right in receivables (known as book debts under South African law), due to its frequent use as a securing object in asset-based lending.

3 A proposal of the requirements for the legal efficiency of a secured transactions law framework originated from F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 133 and is discussed in greater detail in 1.2 *infra*.

dispose of the encumbered property by selling or letting it, or acquire or take over the property from the debtor and then settle the bulk of the outstanding debt. Various influences determine whether the framework will yield economic benefit; these are considered in 1.2 *infra*.[4]

There are several reasons that could explain why the current South African real security law framework is ineffective. Firstly, the current framework is 'conceptually dysfunctional'.[5] This dysfunctionality arises when the *law* classifies transactions into distinct legal categories (eg, real security and *quasi*-real security) despite those transactions serving the same economic function. Second, the current non-possessory security device – special notarial bonds regulated by the Security by Means of Movable Property Act[6] – is regarded as a *fictitious* pledge. Creating a non-possessory security device having the characteristics of a fictitious pledge is a 'very clumsy way of creating a form of real security'.[7] Other issues associated with special notarial bonds under the SMPA include the cumbersome registration process used to constitute this non-possessory real right. The registration process is cumbersome not only because of the time and effort required to register the notarial bond, but also as a result of compliance with the strict specificity requirement used as the standard to describe the bonded property. Moreover, the current legal framework is insufficiently comprehensive to allow a debtor to use the full inherent value of *all* her assets, and, equally important, to use a single security device to take security in different types of movable asset. For example, a special notarial bond under the SMPA does not extend to incorporeal movable property, floating assets like stock-in-trade, or proceeds from the asset. However, a registered general notarial bond does address some of the deficiencies associated with special notarial bonds. Nevertheless, a general notarial bond remains a *possessory* security device with its own shortcomings. Consequently, Chapter 2 of this study considers these and other issues associated with security devices included in the South African framework. As part of the process of establishing the general elements of an effective real security law framework, other legal frameworks are used as benchmarks to

4 The legal efficiency elements are revisited in Chapter 5 paragraph 5.2.1 *infra*.

5 'Conceptual dysfunctionalism' is a term used by McCormack to describe the nature of the then Singapore secured transactions law framework. See G McCormack 'Reforming the law of security interests: national and international perspectives' 2003 *Sing J Legal Stud* 1 at 37.

6 Act 57 of 1993 (SMPA). The Act came into operation on 7 May 1993. See GN 783 in *GG* 14786 of 7 May 1993.

7 See C van der Walt, G Pienaar & C Louw 'Sekerheidstelling deur middel van roerende goed-nog steeds onsekerheid!' (1994) 57 *THRHR* 614 at 618, 619 (reference to the Afrikaans word 'lomp' [clumsy] is used by the authors), where they question whether it was necessary to include a pledge provision in respect of a notarial bond under the SMPA.

determine what would make a secured transactions law framework effective – in our present context, a framework that is *legally* efficient.

1.1.1 Point of reference for identifying elements of an effective real security law framework

The lack of reform in South Africa is in sharp contrast to the increased attention directed at the reform of secured transactions law in various other national legal jurisdictions,[8] including fellow African countries.[9] This impetus in national reform is sparked by an increased *global* interest in secured transactions law reform. Accordingly, there are multiple international and regional reform initiatives related to security rights in movable property. Van Erp refers to the 'osmosis of national, regional and global property law'.[10] These international and regional frameworks serve as inspiration for how to create an effective South African legal framework. The international contributions to secured transactions law reform originated in the United Nations Commission on International Trade Law (UNCITRAL),[11] the International Institute for the Unification of Private Law (UNIDROIT),[12] the World Bank,[13] and the Hague

8 A list of countries that have adopted Personal Property Securities Acts (PPSA) includes: New Zealand (Personal Property Securities Act 126 of 1999 which entered into force on 1 May 2002*)*; Australia (Personal Property Securities Act 130 of 2009, which entered into force on 30 January 2012); Provinces of Canada (Personal Property Security Act, 1993), but with the exception of Quebec province where security rights are regulated by the Civil Code. Countries where the Civil Codes were amended include, Belgium with the amendment of the Belgium Civil Code 1804, more specifically Title XVII of Book III of the Civil Code (Wet tot wijziging van het Burgerlijk Wetboek wat de zakelijke zekerheden of roerende goederen betreft en tot opheffing van bepalingen ter zake 11 Julie 2013, (the Belgian Pledge Act of 11 July 2013) which came into operation on 1 January 2018); Mexico (the Mexican Commercial Code and General Law of Credit Instruments was amended to create a non-possessory pledge over the entire business of a debtor and establish a unified registry for movable property), to name but a few. Arguably, it is easier to incorporate the PPSA-type approach into a common law jurisdiction familiar with the concept of 'equity'.

9 African countries which have reformed or are in the process of reforming their secured transactions laws include: Zambia (Movable Property Security Interest Act 3 of 2016 with the asset register becoming operational from 2016); Ghana with the support of the IFC (a collateral registry was launched under the Borrowers and Lenders Act 773 of 2008); Malawi (Personal Property Security Act 8 of 2013 and Personal Property Security Regulations, 2015, with the registry operational from November 2015); Nigeria (Secured Transactions in Movable Assets Act 3 of 2017 which came into force on 30 May 2017); and Zimbabwe (Movable Property Security Interests Act 9 of 2017, date of commencement to be determined), to name but a few.

10 See S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1065-1068.

11 See Chapter 3 paragraph 3.1 *infra* for a list of the international instruments prepared by UNIDROIT.

12 See Chapter 3 paragraph 3.3.1 *infra* for a list of the international instruments prepared by UNCITRAL.

13 It would be more correct to refer to the World Bank Group. The Group consists of five units which include: the International Bank for Reconstruction and Development (IBRD); the International Development Association (IDA); the International Finance Corporation (IFC); the Multilateral Investment Guarantee Agency (MIGA); and the International Centre for Settlement of Investment Disputes (ICSID). This organisational structure was retrieved from the World Bank website at http://www.worldbank.org/en/about/unit (date of access: 20 April 2018).

Conference on Private International Law.[14] The international reform initiatives are discussed further in Chapter 3 of this study. The regional contributions include those from the *Organisation pour l' Harmonisation en Afrique due Droit des Affaires* (Organisation for the Harmonisation of Business Law in Africa), the Organization of American States, the Asian Development Bank, and the European Bank for Reconstruction and Development.[15] Chapter 4 of this study is devoted to regional reform projects.

It is evident from the above discussion that both a horizontal and a vertical comparative study can potentially guide future reform of the South African framework.[16] However, in this study a vertical comparative approach is preferred. Using a vertical comparative approach means that certain international and regional legal frameworks for secured transactions law are consulted as benchmarks in creating the South African framework that will be used to reform the law of security rights in movable property. Consequently, this study offers a novel contribution by producing a legal framework founded in universally recognised legal principles which may be called into play in reforming the South African law of security rights in movable property. A diligent search revealed that no such framework currently exists within the South African context.[17]

1.1.2 Potential design for the South African reform

The increased global interest arguably also influences the preferred route for South African law reform. A legal transfer of principles is generally the result of comparative analysis. This study intends to set out the preferred route for South African law reform which will render the current real security law framework effective. Reform typically takes place through domestic legislators borrowing concepts or entire legal frameworks, through courts introducing foreign law, or global commercial practice becoming law.[18]

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14 These instruments from this organisation relate to securities (for example, shares), and although they fall outside the scope of this study, they must be mentioned.

15 See Chapter 4 paragraph 4.1.1 *infra* for a list of the specific regional instruments prepared by each organisation. Book XI (*Proprietary Security in Movable Assets*) as part of the Draft Common Frame of Reference was not prepared by an organisation *per se* but is a regional project.

16 A horizontal study will use a national domestic jurisdiction as inspiration, while a vertical study uses international or regional legal instruments as the blueprint for domestic legal reform.

17 The framework can possibly be used for domestic law reform elsewhere.

18 J Fedtke 'Legal transplants in law' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 550.

Consequently, legal reform can take place in one of two directions. Firstly, the reform is either piecemeal or targeted,[19] and the former is the route considered appropriate in this thesis for the South African real security law framework.[20] Essentially, this means that one does not reform an entire framework, but rather effects smaller changes to 'pieces' of the legal framework. This is why a knowledge of what elements would make a framework legally efficient, is important in identifying which components of an extant legal framework need to be revised.

The alternative involves the wholesale (or targeted) reform of an entire framework. Ordinarily, where wholesale reform is chosen, a unitary approach is adopted. The unitary approach entails that a universal concept of either a security interest (or a security right)[21] is used to denote *all* rights originating from any secured transaction. The approach is adopted regardless of the form of the security device, so it will apply equally to a pledge or retention-of-title, for example. Thus, as all security interests (or security rights) perform an identical function, they should be regulated by an identical (or very similar) legal framework.[22] The concept of a 'security right' is discussed in greater detail *infra*.[23] The unitary approach is generally adopted along with the implementation of the functional approach.[24] Article 9 of the Uniform Commercial Code of the United States of America (UCC Article 9)[25] is considered the primary source for most secured transactions law reform.[26] Importantly, the unitary concept of a 'security interest' was introduced by the UCC Article 9.[27]

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19 See L Gullifer 'Piecemeal reform: is it the answer' in F Dahan *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 421. See also M Dubovec & C Kambili 'Using the UNCITRAL Legislative Guide as a tool for secured transactions reform in sub-Saharan Africa: the case of Malawi' (2013) 30 *Ariz J Int'l & Comp L* 163 at 179.

20 See Chapter 5 paragraph 5.4.1.2 *infra*.

21 The terms 'security interest' and 'security right' are used interchangeably in this study. 'Security interest' is used in UCC Article 9 and legal jurisdictions which follow UCC Article 9. 'Security right' is preferred in the UNCITRAL instruments as it is easier to translate in all the official language of the United Nations.

22 MG Bridge *et al* 'Formalism, functionalism, and understanding the law of secured transactions' (1999) 44 *McGill LJ* 567 at 572.

23 See Chapter 3 paragraph 3.3.3.1(*a*) *infra*.

24 This approach implies that as all secured transactions have the same economic function, it is possible to subject security rights to an identical, or at least a similar, legal framework. See MG Bridge *et al* 'Formalism, functionalism, and understanding the law of secured transactions' (1999) 44 *McGill LJ* 567 at 572. See also Chapter 3 paragraph 3.3.3.2 *infra* for a more detailed discussion of the 'functional approach'.

25 UCC is divided into eleven parts referred to as 'articles'. UCC Article 9 deals with secured transactions, sales of accounts, and chattel paper.

26 See HC Sigman 'Security in movables in the US-Uniform Commercial Code Article 9: a basis for comparison' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 60-64 for a brief discussion of the history and context of Article 9.

27 Although the UCC Article 9 is not federal, it has been enacted in all US states, including the mixed-legal system of Louisiana. See HC Sigman 'Security in movables in the US-Uniform Commercial Code Article

1.1.3 Explanation of the layout of the remainder of this chapter

The intended outcome of this research is to recommend how to improve the legal efficacy of the South African legal framework for security rights in movable property. Achieving this outcome involves a three-pronged approach.

Firstly, it is necessary to determine the meaning of 'effecient' within the context of a *legal* framework involving the creation of a security right in movable property.[28] Then, the second element involves scrutinizing, which key policy objectives and fundamental principles (policies), if included, will render a framework legally efficient.[29] Part of this second enquiry includes examining specific components of different legal frameworks. These components (or concepts) include: (1) the creation of a security right in movable property; (2) the third-party effect of that security right; (3) the priority rules which apply between secured creditors; and (4) the enforcement measures associated with a legal framework. As regards this second part of the examination, there are certain elements of any typical secured transactions law framework – discussed *infra* in paragraph 1.4 – which provide the connection between the discussions in Chapters 2 to 4. These also represent the research questions of this study, which, if answered, will achieve the aim of the study which is to establish to what extent the current South African real security law framework for corporeal movable property, should be reformed to make it effective.

The final phase of the study includes, first, recommending the elements required for an efficient legal framework for secured transactions in South Africa. This is done by using the key policy objectives and fundamental principles taken from international and regional frameworks, as examined in Chapters 3 (international framework) and 4 (regional framework). The second element of this final phase is to take the framework recommended in Chapter 5, and testing the current South African framework against it.[30] This evaluation will make it possible to recommend how the current South African framework needs to reform to become efficient.

Further, to provide the scientific foundation for this comparative study, a modern functional comparative approach is adopted in the *vertical* comparative study of selected

9: a basis for comparison' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 60, 62.

28 This forms the topic of paragraph 1.2 *infra*.

29 The significance of key objectives and fundamental principles in this study are explored in paragraph 1.3 *infra*. This forms the foundation for the discussion of the key objectives and fundamental principles included in the international and regional legal instruments discussed in Chapters 3 and 4 *infra*.

30 See the recommendations made in Chapter 5 paragraphs 5.3 and 5.4 *infra*.

international and regional frameworks. Even though the traditional functional comparative approach is well established, a deviation from this traditional approach is suggested *infra* to complement the specific aim and approach adopted in this study.[31]

1.2 Efficacy of secured transactions law frameworks: analysis and reform

There is no universally accepted test to measure the *efficiency* of a secured transactions law framework. Nevertheless, the interrelationship between legal efficiency and economic efficiency is an important point of departure for such an evaluation.[32] Ultimately, the practical implementation of secured transaction laws should achieve an economic function.[33] The law will be legally efficient if it is 'meaningful in the context in which it is applied to citizens' (ie, fulfilling the legal function) and results in commerce wishing to use the specific law.[34] However, in saying this, the correct approach is to consider legal efficiency as the principal element and commercial (or economic) efficiency as a constituent element of legal efficiency.

Fairgrieve refers to the 'economic efficacy' of secured transactions law.[35] Dahan and Simpson suggest that legal efficiency is determined by examining the basic *legal* function of secured transactions law, followed by an exploration of whether that legal function leads to an economic benefit.[36] The economic function of a workable secured transactions law means that security has a micro-economic function which links to the direct benefit of security for the creditor and debtor, and then a macro-economic function where the combined micro-economic

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31 This forms the topic of paragraph 1.5 *infra*.

32 McCormack refers to secured credit as 'the oil of the economy and the engine of economic growth'. See G McCormack *Secured Credit under English and American Law* (2004) at 15. See also R Michaels 'Comparative law by numbers? Legal origins thesis. *Doing Business* reports, and the silence of the traditional comparative law' (2009) 57 *AJCL* 765 at 777 and R Michaels 'The second wave of comparative law and economics' (2009) *U Tor LJ* 197 at 199, which confirms the 'proximity between functionalist comparative law and economics' where economic efficiency may be used as a benchmark against which to measure a legal system.

33 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 490 confirming this as the foundation of EBRD initiatives.

34 LF Del Duca & AA Levasseur 'Impact of legal culture and legal transplants on the evolution of the US legal system' (2010) 58 *Am J Comp L* at 1.

35 See D Fairgrieve 'Reforming secured transactions laws in Central and Eastern Europe' (1998) July/August *Eur Bus L Rev* 254 at 254 where the author states that the primary consideration for reform must be the 'economic efficacy of the law'.

36 See F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' 2008-2009 *Penn St Int'l L Rev* at 635 (republished in F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 133).

benefits culminate in a benefit for the entire economy.[37] This second criterion, as suggested by Dahan and Simpson, corresponds to the idea of 'economic efficacy' also suggested by Fairgrieve. As mentioned above, the basic legal function of secured transactions law involves a secured creditor holding adequate and enforceable security in the *encumbered property*. Accordingly, the legal framework should result in the secured creditor perceiving the risk of advancing credit as significantly lower due to the strength of her security right. The second benchmark, maximising the economic benefit of secured transactions law,[38] consists of specific elements.[39] These elements include: (1) the simplicity of the entire framework;[40] (2) whether costs associated with creating the security right are balanced against the value of the security;[41] (3) the speed of the entire process;[42] (4) the certainty relating to the security device;[43] and (5) the fit-to-context of the specific legal framework. The need for reform in a specific context, links to the reform being required to achieve government policy. Consequently, the legal framework operates in a manner that would maximise the economic benefit resulting from this framework where it is possible to create and enforce a security right swiftly, in a simple yet cost effective manner, while the law is certain and fits the context of the country.[44]

According to Fairgrieve, determining the 'economic efficacy' of the secured transactions framework requires an examination of the following elements: (1) the security right should

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37 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for a UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 490, 491.

38 This can also be referred to as the commercial reality within which the secured transaction framework must function.

39 Some of these aspects correspond to key policy objectives or fundamental policies introduced in paragraph 1.3 *infra*.

40 This does not mean 'simplistic' according to the authors. Dahan & Simpson are correct that this is the balance between the simplest way to achieve what the markets need. See F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 134.

41 The cost of enforcing a security right can sometimes exceed the value of the hypothecated property. See N De La Peña 'Reforming the legal framework for security interests in mobile property' (1992) 2 *Unif L Rev* 347 at 350. Consequently, the cost must not relate only to the creation of the security, but also what it would cost to enforce the security right.

42 Generally, a faster process is more efficient. However, the exception relates to allowing the correct cooling-off or grace periods to balance the rights of all the parties. See F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 134.

43 It is difficult to measure certainty, but transparency will go a long way to strengthening certainty. See F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 135.

44 F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 134. See Chapter 5 paragraph 5.2.1 *infra* where the application of the components of legal efficiency is discussed.

comply with the essential qualities of a right *in rem*;[45] (2) it must be possible to grant security in the widest possible scope of circumstances;[46] (3) the existence of the pledge (security right) over the property should be publicised effectively;[47] (4) enforcement to recover the outstanding debt should be quick and cost-effective;[48] and (5) the costs associated with creating, maintaining, and exercising the right should be reasonable.[49] Fairgrieve does not refer to 'legal efficacy' *per se*. Nevertheless, I argue that the fact that 'economic efficacy' is achieved by what are basically specific legal objectives shows the interrelation between legal efficacy and economic efficacy. Also, all items on this list comfortably fit under the components determining the economic benefit of secured transaction laws already mentioned.

Alternatively, another efficacy benchmark is to list modern principles for a secured transactions law framework without direct reference to legal or economic efficacy. Mooney recommends that modern principles for secured transactions law include:[50] (1) public notice as a standard requirement for third-party effectiveness;[51] (2) improved certainty through priority rules that are 'clear and predictable'; (3) the possibility of encumbering all types of movable property, including future assets; thus the scope of the security devices which can be used, must be extensive; (4) party autonomy is generally accepted as part of the framework;[52] (5) there must be acceleration to enforce the security rights after the debtor's default; (6) there must be an extension of the security right to the proceeds resulting from the collateral; (7) and the framework must allow free assignability of receivables.[53]

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45 D Fairgrieve 'Reforming secured transactions laws in Central and Eastern Europe' (1998) July/August *Eur Bus L Rev* 254 at 255. This is also included under the EBRD Core Principles for a Secured Transactions Law.

46 This means that any person or entity must be able to give and receive security over assets and it must be able to give security over all types of asset. See D Fairgrieve 'Reforming secured transactions laws in Central and Eastern Europe' (1998) July/August *Eur Bus L Rev* 254 at 255.

47 The author refers to a pledge, but it is assumed that this reference is to the wider meaning. See D Fairgrieve 'Reforming secured transactions laws in Central and Eastern Europe' (1998) July/August *Eur Bus L Rev* 254 at 255.

48 Fairgrieve is correct that how a security right can be enforced will have the greatest influence on determining the actual value of the security device. See D Fairgrieve 'Reforming secured transactions laws in Central and Eastern Europe' (1998) July/August *Eur Bus L Rev* 254 at 255, 256.

49 D Fairgrieve 'Reforming secured transactions laws in Central and Eastern Europe' (1998) July/August *Eur Bus L Rev* 254 at 254. The creditor is not going to carry this cost, so they add it to the cost of the credit.

50 CW Mooney Jr 'Choice-of-law rules for secured transactions: an interest-based and modern principles-based framework for assessment' (2017) 22 *Unif L Rev* 842 at 847.

51 The word 'general' supposes that the new framework will still allow possession to establish third-party effectiveness, but that, as far as possible, registration must be the first choice for publicity.

52 This is not a principle put forward directly by Dahan & Simpson, but 'fit-to-context' will include an element of party autonomy as the parties include provisions in the security agreement to fit the requirements of the context of their transaction.

53 'Receivables' would be a functional overarching term which refers to claims (including book debts) (the South African term), debt claims (the term in Belgian law), or accounts (the term under the UCC Article 9) under domestic law.

There is an overlap in the fundamentals of what constitutes an effective secured transactions law framework as detailed by Dahan and Simpson, Fairgrieve, and Mooney. The emphasis is on effective publicity through registration,[54] flexibility in the assets used as security, clear and predictable rules for priority, and quick and cost-effective enforcement procedures. Only Mooney includes party autonomy and extension of the security right to the proceeds as fundamental elements.[55] Regardless of the approach followed, the outcome remains the same: the general assumption is that adopting certain key policy objectives and fundamental principles will result in a secured transactions law framework, which framework is essentially legally efficient. In effect, legal and commercial efficacy cannot be separated. Accordingly, the criteria suggested by Dahan and Simpson, where the economic benefit of the framework is an element of the legal efficiency test, appears to be the correct approach. The corresponding fundamentals presented by the three groups of authors are also echoed in international, regional, and domestic instruments – in the main as key policy objectives (or core principles) and fundamental principles. Indeed, Akseli comments that key objectives and essential policies are the building blocks of international instruments.[56] Therefore, it should be possible to find specific key policy objectives and fundamental principles common to efficient legal frameworks and then to incorporate those objectives and principles into an existing legal framework so making that framework effective.

In the final analysis, there is an interrelationship between the key policy objectives and fundamental principles of a legal framework, and achieving an efficient legal framework for security rights in movable property. Put differently and contextually, implementing specific key policy objectives and fundamental principles (policies) would presumably result in an effective real security law framework for South Africa. These two concepts are also interrelated as shown.

1.3 Interrelationship between key policy objectives and fundamental principles (or policies)

54 Registration is sometimes thought of as a synonym for 'notice filing', a concept coined by the drafters of UCC Article 9. However, under South African law, registration more accurately refers to 'transaction-filing' and therefore 'registration' and 'notice-filing' are not used interchangeably in this study.

55 This is in line with the UNCITRAL approach discussed in Chapter 3 paragraph 3.3.2(*i*) *infra*.

56 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 44.

A country will typically enact laws aimed at a specific agenda which is linked to general government policy. To promote this policy agenda, laws are drafted with the view to achieving specific key policy objectives. These objectives are potentially either located in the long title of a statute or the statute's purpose section. Where it is on a country's agenda to develop an effective legal framework in respect of security rights in movable property, that country should ideally identify those fundamental principles (or policies) that would result in realising the key policy objectives necessary to create an effective legal framework. Accordingly, a fundamental principle is broader and more detailed than a key policy objective. The fundamental principle forms the basis for the content included as part of the text of a legal instrument.

The UNCITRAL Legislative Guide on Secured Transactions (UNCITRAL Guide) and the UNCITRAL Model Law on Secured Transactions (UNCITRAL Model Law) were drafted in the light of the interrelationship between these aspects.[57] The UNCITRAL Guide contains key policy objectives which provide the general policy framework for a country to enact a modern secured transactions law.[58] The fundamental principles (or policies) contained in the UNCITRAL Guide, and followed in the UNCITRAL Model Law, provide the link between the key policy objectives and their practical implementation through the recommendations.[59] Put simply, the fundamental principles are the building blocks required to achieve the key policy objectives, ultimately resulting in an effective secured transactions law framework.[60] The regional instruments discussed in Chapter 4 contain similar key policy objectives (or core principles) and fundamental principles. At this point it must be noted that the legal instruments mentioned *supra* are examples of soft-law instruments. These principles are regarded as 'soft law principles' – essentially non-binding general principles – but achieve 'the salutary goal of creating broad international standards'.[61]

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57 See the Introduction to the UNCITRAL Guide para 60 at 22, explaining this interrelationship. Then see the UNCITRAL Model Law on Secured Transactions: Guide to Enactment para 18 at 8 which states that the key policy objectives and fundamental principles of the Guide and Model Law are the same, and further that the key objectives of these instruments should be included in a preamble, or similar paragraph, in statutes drafted according to the UNCITRAL Model Law on Secured Transactions.

58 SV Bazinas 'Key objectives and fundamental principles of the UNCITRAL Legislative Guide on Secured Transactions' (2008) 1 *Insolvency and Restructuring International* 42 at 45.

59 SV Bazinas 'Key objectives and fundamental principles of the UNCITRAL Legislative Guide on Secured Transactions' (2008) 1 *Insolvency and Restructuring International* 42 at 45.

60 Even though the Guide refers to 'fundamental policies', I submit that fundamental principles means the same, which term is also preferred in SV Bazinas 'Key objectives and fundamental principles of the UNCITRAL Legislative Guide on Secured Transactions' (2008) 1 *Insolvency Restructuring International* 42-48. Also, the term 'fundamental principle' coincides with the use of 'fundamental principles' that form part of a domestic property law system (see 1.5.2.3 *infra*).

61 As regards the application of soft-law principles in international commercial law (also secured transactions law), see HD Gabriel 'The advantages of soft law in international commercial law: the role of UNIDROIT,

Corresponding fundamental policies or principles that operate successfully within the different legal systems may share historical origins. Dalhuisen suggests that even though there is not a revival of the *Ius Commune* as such, a search for legal principles which formed part of it and which are similar across legal systems may prove useful. This applies equally to secured transactions law reform.[62] These principles may then be used to build a 'reasonably coherent legal framework of rules' with the principles as the centre of the framework.[63] Identified fundamental principles or policies can then be used to 'modernise' property law. This, in turn, links back to the fundamental principles (mentioned *supra*) serving as the building blocks for achieving the key policy objectives.

A legal framework consists of specific elements. These elements must be examined to identify the key policy objectives and fundamental principles of that framework. Ultimately, this informs the choice of which key policy objective or a fundamental principle should form part of a future framework. The elements of different legal frameworks are discussed in Chapter 2 (the South African framework), Chapter 3 (the international frameworks), and Chapter 4 (the regional frameworks).

1.4 Elements (concepts) of a framework that must be examined for reform

The first step in a comparative study is to identify the concepts common across the legal frameworks selected, which will form the foundation for the comparative study.[64] Therefore, the concepts relevant to a study involving the reform of secured transactions law include: the creation of the security right; the perfection or third-party-effectiveness of the security right; the method of publicity for the security right; the general rule (and exceptions to the rule) to determine the priority (ranking) of creditor claims; and the enforcement measures available to the creditor wishing to enforce the right.[65] These elements (or concepts) inform what would constitute an effective secured transactions framework. This study, therefore, identifies those

UNCITRAL, and the Hague Conference' (2009) 34 *Brook J Int'l L* at 655-670. The application of soft law to secured transactions law reform is discussed in Chapter 3 paragraph 3.2 *infra*.

62 JH Dalhuisen 'European private law: moving from a closed to an open system of proprietary rights' (2001) 5 *Edin LR* 272 at 275. Further, the appearance of the *Ius Commune* in mixed-legal systems – such as South Africa – sparks researchers' interest in these jurisdictions.

63 JH Dalhuisen 'European private law: moving from a closed to an open system of proprietary rights' (2001) 5 *Edin LR* 272 at 275.

64 AE Örücü 'Methodology of comparative law' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 568.

65 N De La Peña 'Reforming the legal framework for security interests in mobile property' (1992) 2 *Unif L Rev* 347 at 387.

core concepts that need to be considered to determine what would result in an effective secured transactions law framework. The differences and similarities between how the legal frameworks deal with the concepts are identified. An explanation is then offered for why the legal frameworks deal differently with the concepts identified (possibly due to policy considerations or the historical legal foundation). The final element of the study evaluates the treatment of the concepts in the legal frameworks analysed and recommends the most effective approach for South African reform. These elements (or concepts) also inform the research questions, which, if answered, will resolve the problem posed in this study. Although the discussion in Chapters 3 and 4 is structured around the fundamental principles and key policy objectives of each framework, Chapter 5 identifies which fundamental principles and key policy objectives ultimately answer the research questions set in the following paragraphs.[66]

1.4.1 Does a single legal framework result in an effective secured transactions law framework?

The question is whether incorporating a single legal framework for security rights in movable property results in an effective secured transactions law framework. There are different approaches to achieving a uniform framework. Accordingly, it must be decided which approach – unitary, non-unitary, or some other alternative – will be most effective for the South African framework.[67] It must therefore be established whether it is not only achievable but also critical, to eliminate the current 'laundry list' of security devices, and in its place adopt a single security device in line with the unitary approach. In other words: Should a 'single security right' replace the range of traditional security devices?

1.4.2 Should the method used to create a security right be revised?

66 See Chapter 5 paragraph 5.5 *infra*.

67 This is a key question for any secured transaction law reform. See GG Castellano 'Reverse engineering the law' in SV Bazinas & NO Akseli (eds) *International and Comparative Secured Transactions Law: Essays in honour of Roderick A Macdonald* (2017) at 290. A fundamental principle of the UCC Article 9 schemes is a wide definition of 'security interest'. See G McCormack 'Reforming the law of security interests: national and international perspectives' 2003 *Sing J Legal Stud* 1 at 11. However, some recently reformed legal jurisdictions have not introduced the broad notion of 'security interest', but kept the traditional security devices characterisation. See the discussion in E Dirix 'The new Belgian Act on security interests in movable property' (2014) 23 *Int Insolv Rev* 171 at 176.

Are the current requirements for the creation of a security right still effective in the face of modern commercial reality?[68] The main issue here centres on the classification of a security right as a property right – potentially not in the traditional sense (ie, without third-party effect). This question refers to the characteristics of a property right under domestic law. And this, in turn, involves determining if it is possible and advisable to have a *contractually*-created property right which has no third-party effect. This research question also involves the fundamental principle of transparency discussed as a fundamental principle in Chapter 2.[69]

1.4.3 How comprehensive (or inclusive) should the scope of the secured transactions law framework be?

Three separate aspects arise in this regard: (1) the type of property that should form part of the framework;[70] (2) the type of transactions that should be included as part of the framework; and (3) linked to the type of transactions, what obligations can be secured under the framework.

This question, therefore, involves the type of movable property covered under the framework. The application of the framework to proceeds, attachments (fixtures), and mass or commingled goods is particularly relevant. Further, the relationship between the asset and the secured debt (ancillary nature) must be examined. This ancillary relationship is important in creating the proprietary effect of the security right and speaks specifically to whether it is possible to take security in future assets. The question also relates to the application of the transparency principle, specifically the publicity method that can be used, but also the specificity in which the movable asset should be described. Further, the application of *numerus clausus* principle as a fundamental principle[71] will influence the extent to which a new security device can be created, which also impacts on the type of asset that can serve as a security.

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68 Difficulties arising in the creation of security rights is a barrier to effective secured transactions law. See N De La Peña 'Reforming the legal framework for security interests in mobile property' (1992) 2 *Unif L Rev* 347 at 349. Specificity is one of three important elements of property law rules in so-called stricter jurisdictions. The other two are publicity and the prohibition of the *pactum commissorium* (which applies to enforcement). See T Juutilainen 'Secured transactions: centralised or spontaneous harmonisation' (2009-2012) 1 *ESLR* 14, n 11 at 16).

69 See Chapter 2 paragraph 2.3.3.1 *infra*.

70 This depends on the nature of the movable property (eg, corporeal or incorporeal) and the time of acquisition of the property (eg, 'after-acquired property' which includes, *inter alia*, future assets). See F Helsen 'Security in movables revisited: Belgium's rethinking of the Article 9 UCC system' (2015) 6 *Eur Rev Priv Law* 959 at 967-970.

71 See Chapter 2 paragraph 2.3.3.2 *infra* for a discussion of the *numerus clausus* principle.

1.4.4 What is the best method to achieve third-party effectiveness?

How is third-party effectiveness best achieved, and can the creation and third-party effectiveness of the security right happen simultaneously?[72] Differently phrased: What is the legal effect of publicity? The question to consider is whether the security right can be created without any form of publicity (*inter partes*) or whether publicity should be a requirement to create a security right with *erga omnes* enforceability. This question includes finding a method that is not overly cumbersome for the creditor, but that also provides *effective* public notice to third parties. The transparency principle – more specifically the publicity principle – is the relevant fundamental principle relating to this research question.

1.4.5 How predictable and transparent are the current priority rules?

A security right will naturally have a proprietary effect. As a result, a security right influences the priority ranking between different creditors. In this instance, the general rule for determining priority ranking is examined alongside the permitted exceptions to the general rule.[73] The ground rule, *prior tempore potior iure*, is relevant in answering this research question.[74]

1.4.6 Is the current South African legal framework for the *enforcement* of creditors' security rights the most efficient option?

This question speaks to the enforceability of and the methods that can be used to enforce the security right. More specifically, it concerns the extent of court involvement as opposed to self-help in the enforcement process. The question also relates to whether the creditor can take over the asset in satisfaction of the debt and, if so, what requirements should be stipulated in this regard. Also relevant are whether the security right can withstand the debtor's insolvency and

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72 Unreformed legal systems offer limited practical ways for creditors to determine the priority of their security right. See N De La Peña 'Reforming the legal framework for security interests in mobile property' (1992) 2 *Unif L Rev* 347 at 349.

73 To consider those exceptions that should be allowed to the general rules of priority without removing transparency and predictability associated with priority. Clear priority rules are vital to allowing a debtor to use the full economic value of her assets and enabling competing creditors to know exactly where they rank. See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 225.

74 The principle entails that the first party to file a notice or acquire possession of the encumbered property will have priority over the claims of subsequent creditors. See Chapter 2 paragraph 2.3.3.3(*c*) *infra* for a discussion of this rule.

the implications for insolvency legislation in general. In this regard, the ground rules that: (1) prohibit a *pactum commissorium* (a forfeiture clause);[75] (2) prohibit self-help,[76] and (3) the doctrine of non-pursuit (the maxim *mobilia non habent sequelam*) are considered.[77]

1.4.7 Should there be equal treatment of all creditors providing debtors with credit to acquire movable assets?

A creditor is either: (1) the seller of goods *and* a credit provider; or (2) simply a lender. Traditionally, a seller may use reservation of ownership as security for the repayment of debt. As ownership is used as security, the seller will have remedies which differ from those available to the holder of a mere security right (the lender). Accordingly, it should be established to what extent it is possible to treat different types of creditor equally in a single real security law framework.

The foundation for effective reform is built on finding the correct key policy objectives and fundamental principles to include in the framework. However, to be able to compare the key policy objectives and fundamental principles both horizontally and vertically, an adapted version of the functional comparative approach is suggested. The next paragraph describes how the traditional functional comparative approach is adapted so that the purpose of this study can be achieved.

1.5 The comparative law approach suited to this study

1.5.1 Concept of comparative law and the application to aspects of property law

In simple terms, comparative law involves the intellectual activity of the comparatist in comparing 'different legal systems of the world'.[78] Modern comparative law no longer only requires a horizontal comparison between national legal systems, but also necessitates a vertical comparison with regional and international legal frameworks.[79] This vertical comparison is particularly relevant in the case of modern property law,[80] and even more so in the specific

75 See Chapter 2 paragraph 2.3.3.3 (*e*) *infra*.
76 See Chapter 2 paragraph 2.3.3.3 (*f*) *infra*.
77 See Chapter 2 paragraph 2.3.3.3 (*g*) *infra*.
78 K Zweigert & H Kötz *An Introduction to Comparative Law* (3rd ed 1998) at 2.
79 This is either in the form of soft law or hard law. See Chapter 3 paragraph 3.2 *infra* for a brief discussion of the interrelationship between soft law and secured transactions law.
80 JM Smits 'Taking functionalism seriously: on the bright future of a contested method' (2011) 18 *Maastricht J Eur & Comp L* 554 at 556 identifies exclusive horizontal application as an issue of the

field of secured transactions law. Thus, comparative law in a modern context boils down to either comparing entire legal jurisdictions (or legal frameworks) with each other (macro-comparison), or comparing only certain aspects of legal jurisdictions (or legal frameworks) (micro-comparison).[81] If the comparison process is broken down, it concerns comparing those legal rules, legal institutions, and legal concepts that form part of different legal jurisdictions (or legal frameworks) with each other.[82] The purpose of a comparative legal study is, therefore: (1) to find convergence and/or divergence between the legal rules, legal institutions, and concepts; but more importantly, (2) to use the method of another legal jurisdiction (or a legal framework) to guide national law reform, this being the practical purpose behind conducting a comparative legal study.[83]

Undoubtedly a comparative study of any aspect of property law is ambitious. The difficulty originates, in part, in the differences between: (1) the foundations of the distinct legal families; (2) the diversity in the terminology used between different legal systems (or frameworks);[84] and (3) the tendency of many property lawyers to resist change influenced by foreign property laws unfamiliar to them.[85] This study concedes that the general apprehension raised by the idea of foreign law influencing national property law will attract resistance. This notwithstanding, the topic of this study – secured transactions law in respect of movable property – is more receptive to comparative influences.[86]

Röver points out that referring to 'comparative law' is misleading, and it is more accurate to talk of a comparison of law where the focus falls on the *method* or *approach* used to compare.[87] Thus, this thesis refers to the approach (the modern functional comparative

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traditional functional method. Further, see the international and regional organisations and instruments listed and discussed in Chapters 3 and 4 *infra*, showing the need for a vertical comparison concerning secured transactions law.

81 S Scott 'The comparative method in action: aspects of the law of cession (Part 1)' (2000) 33 *De Jure* 211 at 212. See also K Zweigert & H Kötz *An Introduction to Comparative Law* (3rd ed 1998) at 4, 5.

82 B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 7 available at https://papers.ssrn.com/sol3/ papers.cfm?abstract_id=2394056 (date of access: 24 January 2017).

83 JM Smits 'Taking functionalism seriously: on the bright future of a contested method' (2011) 18 *Maastricht J Eur & Comp L* 554 at 555.

84 See B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 99 and the sources listed at n 21. See also S Scott 'The comparative method in action: aspects of the law of cession (Part 1)' (2000) 33 *De Jure* 211 at 212.

85 C Sganga 'Cracking the citadel walls: a functional approach to cosmopolitan property models within and beyond national property' (2014) 3 *Cambridge J Int'l & Comp L* 770 at 773.

86 See C Godt 'The functional comparative method in European property law' (2013) 2 *EPLJ* 73 at 77. See also, S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1046.

87 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) n 1 at 30.

approach) used to conduct this comparative study. The initial two essential methodological questions which influence the comparative-law approach adopted, are *what* to compare, and *why* to use comparative law to assist with domestic legal reform.[88] In answering the *what*-question, 'things to be compared must be comparable'.[89] This, in turn, relates to the maxims 'like must be compared with like' and '*similia similibus*'.[90] The exact degree of the required 'likeness' or similarity is uncertain, but the functional approach to comparative law can be used to determine 'what is equivalent enough to compare'.[91] Finding what is similar enough to compare, requires identifying a 'common comparative denominator' (a *tertium comparationis*) common to the legal frameworks examined which would result in a meaningful comparison.[92] In simple terms: there must be a standard against which the comparison should take place.[93] In this regard, things are arguably comparable when they fulfil the same function (or objective),[94] or where the legal frameworks share a common goal.[95] The common goals of a legal framework (or of a specific legal rule) can be deduced from the key policy objectives which the intended legal reform seeks to achieve.[96] Indeed, the convergence or 'what is equivalent enough to compare' exists between the fundamental (or leading) principles, legal concepts, and ground rules of legal jurisdictions, but the divergence is then present in the technical rules of the legal framework.[97] The technical legal rules may then represent the historical diversity between legal

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88 B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 4, 10 available at https://papers.ssrn.com/sol3/papers. cfm?abstract_id=2394056 (date of access: 24 January 2017).

89 AE Örücü 'Methodology of comparative law' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 560.

90 AE Örücü 'Methodology of comparative law' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 560.

91 B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 8 available at https://papers.ssrn.com/sol3/papers. cfm?abstract_id=2394056 (date of access: 24 January 2017). See also J De Coninck 'The functional method of comparative law: "quo vadis" ?' (2010) 74 *The Rabel Journal of Comparative and International Private Law* 318 at 323.

92 M Reimann 'The progress and failure of comparative law in the second half of the twentieth century' (2002) 50 *AJCL* 671 at 690 where the author states the importance of having a defined set of 'comparators' which can be used as set standards or measures against which the comparison should take place.

93 AE Örücü 'Methodology of comparative law' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 561.

94 Using the function of legal rules, concepts, or institutions as the comparator is an element of the functional approach to comparative law. See R Michaels 'The functional method of comparative law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 342 in this regard.

95 K Zweigert & H Kötz *An Introduction to Comparative Law* (3rd ed 1998) at 34 and K Zweigert & H Puttfarken 'Critical evaluation in comparative law' (1976) 5 *Adel LR* 343 at 345. See also AE Örücü 'Methodology of comparative law' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 561, adding the reference to achieving a 'common goal'. See further B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 8 available at https://papers.ssrn.com/sol3/papers. cfm?abstract_id=2394056 (date of access: 24 January 2017).

96 See paragraph 1.3 *supra*.

97 This was raised by Van Erp. See the reference in B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 and the source listed in n 37 at 9

jurisdictions (or the influence of historical diversity on regional and international frameworks). A 'supra-level' of distinction can be added in terms of which the politico-legal policy choices will also influence the divergence or similarities between legal frameworks.[98] An example would be where government policy considers the legal approach to retention-of-title devices followed by its major trading partners as part of a legal reform process.

Some of the reasons *why* a comparative study is undertaken include: (1) to determine how other legal systems resolve a similar problem; (2) to arrive at an *overview* of problems or solutions in a legal system; (3) to understand vertical dynamics (hence law created by regional and/or international organisations); and (4) to use comparative law as the foundation for creating something new.[99] Consequently, the *why*-question should go beyond merely wishing to find similarities and differences between legal systems (or legal frameworks) (which were the contrasting approaches under previous constructions of the functional comparative law approach).[100] The primary goal is to examine other jurisdictions 'as a source of inspiration', to resolve a domestic legal problem using an external source as persuasive authority for legal reform.[101]

There is a third methodological question that needs to be added: 'How do we compare'? This *how*-questions is closely connected to the *what*-question discussed *supra*.[102] According to Godt, the dominant question is 'how do we compare', thus how to use a comparative law approach practically.[103] Answering the 'how to compare' question requires that the analytical quality of the comparison be beyond reproach – even more so when a comparatist analyses a

available at https://papers.ssrn.com/sol3/papers. cfm?abstract_id=2394056 (date of access: 24 January 2017). See also the reference in B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 96, 109, and S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1050, 1051 where the author does not mention the functional comparative approach *per se* but refers to the possibility of convergence in the manner mentioned above.

98 This is an extension of Van Erp's 'three-level approach'. See the reference in B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 and the source listed in n 37 at 9 available at https://papers.ssrn.com/sol3/papers. cfm?abstract_id=2394056 (date of access: 24 January 2017).

99 B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 4, 5 available at https://papers.ssrn.com/sol3/papers. cfm?abstract_id=2394056 (date of access: 24 January 2017).

100 B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 11 available at https://papers.ssrn.com/sol3/papers. cfm?abstract_id=2394056 (date of access: 24 January 2017).

101 JM Smits 'Taking functionalism seriously: on the bright future of a contested method' (2011) 18 *Maastricht J Eur & Comp L* 554 at 555.

102 M Reimann 'The progress and failure of comparative law in the second half of the twentieth century' (2002) 50 *AJCL* 671 at 689, 690.

103 C Godt 'The functional comparative method in European property law' (2013) 2 *EPLJ* 73 at 75.

legal system in which she has not been trained.[104] Ultimately, the comparatist might ignore certain nuances only known to a native of a legal system. However, I submit that where the purpose of the comparison is to find a better solution for an existing legal problem, the understanding of a foreign system, albeit from the perspective of an outsider, can still be beneficial for the context in which the reform should take place. This *how*-question needs to consider: (1) the distinction between a horizontal and/or vertical comparison; and (2) comparing common-law legal systems with civil-law systems as both systems share a Roman-law foundation.

The purpose the comparative researcher aims to achieve by conducting the comparative study influences which comparative method or approach is chosen[105] and *how* the comparison takes place. This study aims to determine whether the South African real security framework for movable property is effective, and then to make recommendations on how the current framework needs to reform to become effective. Consequently, the research approach requires a benchmark of what constitutes an effective framework against which to measure the South African framework and recommend reform. The purpose will be descriptive in identifying different available solutions (or alternatives) on how to reform specific concepts identified as part of the research questions posed in this study.[106] The study further includes a normative element where the commonality between the legal frameworks examined is used to create the benchmark to be used as the foundation to reform the South African real security law framework.[107] Thus, in answering the *why*-question, the study needs to use comparative law to establish a benchmark as to what the key policy objectives and fundamental principles of an effective real security law framework include. The 'inspiration' for this common framework will, for the purposes of this thesis, emerge from the vertical appraisal of relevant legal

104 C Godt 'The functional comparative method in European property law' (2013) 2 *EPLJ* 73 at 75.

105 AE Örücü 'Methodology of comparative law' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 573. See also, K Zweigert & H-J Puttfarken 'Critical evaluation in comparative law' (1976) 5 *Adel LR* 343 at 345 and B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 3 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2394056 (date of access: 24 January 2017), and B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 96. See further, C Sganga 'Cracking the citadel walls: a functional approach to cosmopolitan property models within and beyond national property' (2014) 3 *Cambridge J Int'l & Comp L* 770 at 788 and AF Salomons 'Comparative law and the quest for optimal rules on the transfer of movables for Europe' (2013) 2 *EPLJ* 54 at 57. See also, J De Coninck 'The functional method of comparative law: "quo vadis" ?' (2010) 74 *The Rabel Journal of Comparative and International Private Law* 318 at 320.

106 See paragraph 1.4 *supra.*

107 Indeed, according to B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 97, the modern functional comparative method (the approach used in this study) is recommended as the only method suitable for a study which includes a descriptive and normative element.

frameworks in respect of secured transactions law. This source of inspiration for the recommended reform requires a specific research approach – the *modern* functional comparative approach. The remaining methodological questions, the *what*-question and the *how*-question, are answered within the context of the comparative law approach to which we now turn.

1.5.2 A modern functional comparative law approach

The purposes of this paragraph are to: (1) briefly discuss the development of the functional comparative approach (also referred to as 'the functional comparative method'); (2) raise some of the criticism against and/or limitations of this method/approach; (3) explain a possible modern manifestation of the functional comparative law approach; and (4) briefly explain how this modern functional comparative law approach is adopted so that the purpose behind this study is achieved.

1.5.2.1 The development of the functional comparative approach

It is not the aim of this paragraph to debate the theoretical foundation or the broader recognition of the functional method/approach (or functionalism) as a comparative-law method. The purpose is to explain the traditional manifestation of the functional approach and to recommend a modern functional comparative approach that is suited to this study. After all, the form of the comparative law approach chosen should be based on what the researcher intends to achieve with a study, which also extends to the adaptation of the research approach used in the comparative legal study.

Rabel is regarded as the first comparatist to introduce functionalism as a methodological principle in comparative law.[108] Michaels postulates that it was never Rabel's intention to create an elaborate comparative method; what he had in mind was a more pragmatic functional method.[109] The best exposition of Rabel's concept of functionalism came from Zweigert and Kötz; the crux of this expansion is discussed *infra*. In principle, there is no single 'functional

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108 J Husa 'Functional method in comparative law – much ado about nothing?' (2013) 2 *EPLJ* 4 at 10. See also, J De Coninck 'The functional method of comparative law: "quo vadis" ?' (2010) 74 *The Rabel Journal of Comparative and International Private Law* 318 at 321 with reference to Rabel as the 'founding father' of this method.

109 R Michaels 'The functional method of comparative law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 362.

method', but rather a 'collection of methods' each evidencing elements of functionalism.[110] So, at the core of all comparative law methods (or approaches) lies the principle of functionality (or functionalism).[111] More precisely, functionalism is one of many approaches used in conducting a micro-comparative legal study.[112] 'Functionality' in essence entails that once the purpose or function behind a legal rule is known, it is possible to measure whether the function or purpose behind a legal rule, legal concept, or legal institution, has or has not been met. The functional approach is, therefore, used to identify those concepts, institutions, or rules, which will fulfil the same purpose or objective in another legal system. These would then allow the comparison to take place.[113]

In the practical context of potential legal reform (the topic of this thesis), 'purpose or function' entails the outcome the drafters or creators of laws intend to achieve by incorporating a specific rule or principle, and the intended function the rule or principle will serve as the common comparator (*tertium comparationis*).[114] More specifically, as this study follows a vertical comparative approach, the hypothetical function or purpose served by a recommendation of legal rules or principles by international and regional organisations, constitutes the common comparator for our purposes.

Simply put, the traditional functional approach to comparative law seeks to compare functional equivalents with the presumption of similarities between legal systems (*praesumptio similitudinis*) as regards the functional equivalent solutions to legal problems shared by different legal systems. This is the traditional approach expanded on by Zweigert and Kötz. The crux of Zweigert and Kötz's approach is that all legal systems share the same legal or social problems but resolve these problems differently, yet often with similar (functional)

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110 B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 108. See also R Michaels 'The functional method of comparative law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 342.

111 K Zweigert & H Kötz *An Introduction to Comparative Law* (3rd ed 1998) at 34 and K Zweigert and H-J Puttfarken 'Critical evaluation in comparative law' (1976) 5 (4) *Adel LR* 343 at 345.

112 R Michaels 'The functional method of comparative law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 341. See also JM Smits 'Taking functionalism seriously: on the bright future of a contested method' (2011) 18 *Maastricht J Eur & Comp L* 554 at 557.

113 B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 8 available https://papers.ssrn.com/sol3/papers. cfm?abstract_id=2394056 (date of access: 24 January 2017).

114 This is one of seven functions set out by Michaels. The other functions are: (1) the comparative function of achieving comparability; (2) the presumption function of emphasising similarity; (3) the formalising function of system building; (4) the evaluative function of determining the better law; (5) the universalising function of preparing legal unification; and (6) the critical function of providing tools for the critique of law. See R Michaels 'The functional method of comparative law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 363-380.

outcomes across legal jurisdictions.[115] Traditionally, the functional method started from the presumption of similarities (*praesumptio similitudinis)* between issues in legal systems, but also recognised the 'sameness' of the legal solutions (or outcomes). As basis is the assumption that all legal jurisdictions share the same problems[116] but each has its individual social system. The result is that while two systems may may arrive at the same end solution, their social systems may have dictated their applying different methods to resolve a legal problem.[117] Consequently, where one legal jurisdiction has found a solution to a problem while another has failed to do so, the assumption is that the solution was informed by social values unique to a particular legal jurisdiction.[118] However, a logical explanation is also that the comparatist looked for the legal rule in another legal system in the wrong place. Irrespective of whether the approach of presumption of similarities or the presumption of certain divergence is followed, the crux remains that the analysis should not be limited to what the legal rule says (the doctrinal text) but rather the problems the rule intends to resolve within a legal system.

A modern functional comparative law approach involves recognising certain similarities between legal systems where the functional equivalence is found both in identifying common principles and ground rules, but also in recognising the potential of divergence in the application of the principles and rules in order to resolve a specific legal problem arising from the historical context of the legal system. Further, a practical implementation of the functional method need not assume that legal systems encounter the same legal problems, but more correctly that the functional approach will work when legal systems do encounter the same legal problems.[119] The suggested modern approach is explored further after the synopsis of the potential limitation of the traditional functional comparative approach.

1.5.2.2 Criticism of or limitations in the traditional functional comparative approach

Alhough the functional comparative method (or approach) arguably presents a 'methodological mishmash',[120] the comparatist who uses this approach is more 'pragmatically than

115 K Zweigert & H Kötz *An Introduction to Comparative Law* (3rd ed 1998) at 34.
116 J Husa 'Functional method in comparative law–much ado about nothing?' (2013) 2 *EPLJ* 4 at 10.
117 K Zweigert & H Kötz *Introduction to Comparative Law* (3rd ed 1998) at 35.
118 H Kronke 'The "functional approach" in comparative law, private international law and transnational commercial law: promises and challenges' (2006) 47 *Annales U Sci Budapestinensis Rolando Eotvos* 41 at 42.
119 J Gordley 'The functional method' in PG Monateri (ed) *Methods of Comparative Law* (2012) 107 at 119.
120 R Michaels 'The functional method of comparative law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 362.

methodologically interested',[121] this is not necessarily a reason to discount adopting this approach if the aim of the comparatist is to achieve a result she can respect and which is practically sound.[122] The traditional functional comparative-law method has both its proponants[123] and its detractors[124] and has come in for its fair share of criticism and emphasis on its limitations.

First, it is criticised as an attack on the plurality amongst legal systems.[125] The foundation of this criticism is that legal systems should be different, and this divergence should be protected and preserved. According to Akkermans – referring to the European Union – functionalists *are* attempting to unify the law, but the unification is normative rather than descriptive.[126] The aim is to promote market access between countries and the focus of unification is therefore on the functionality of the legal rules, not necessarily on their doctrinal functioning.[127] In this instance, functionalism manifests as adaptionism where national legal rules are adapted to promote market access.[128]

A further criticism is that the divergence between legal systems is too vast and attempts to incorporate a foreign legal principle may result in a 'legal irritant'.[129] It may not be possible to compare legal rules without proper regard to their legal and cultural context (thus a neutral

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121 R Michaels 'The functional method of comparative law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 362.

122 See J Gordley 'The functional method' in PG Monateri (ed) *Methods of Comparative Law* (2012) 107 at 107 for an interpretation of what the statement by Michaels implies for the comparatist.

123 C Sganga 'Cracking the citadel walls: a functional approach to cosmopolitan property models within and beyond national property' (2014) 3 *Cambridge J Int'l & Comp L* 770 at 774.

124 C Godt 'The functional comparative method in European property law' (2013) 2 *EPLJ* 73 at 73, who notes that this method 'lacks the historic dimension, which puts issues into perspective'. See also J Husa 'Functional method in comparative law–much ado about nothing?' (2013) 2 *EPLJ* 4 at 4 where the author says that 'it is impossible to maintain a straight face and talk about functional comparative law'.

125 See B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 115 and B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 9 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2394056 (date of access: 24 January 2017), who does not raise the criticism, but refers to the source of this criticism by Pierre Legrand.

126 B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 115.

127 B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 115.

128 The law developments in response to the needs of society and the need to adapt to a social need at a given time, in order to survive. See R Michaels 'The functional method of comparative law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 347-349.

129 B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 13 and the sources at n 51 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2394056 (date of access: 24 January 2017). 'Legal irritant' refers to the internal development in a domestic legal system as a result of a legal transplant. See R Michaels 'Comparative law by numbers? legal origins thesis. *Doing Business* reports, and the silence of the traditional comparative law' (2009) 57 *AJCL* 765 at 787.

comparison).[130] This is more a criticism of the *manner* in which a foreign legal solution will be incorporated to fit into a legal jurisdiction. Thus, I argue that it should not be assumed that a legal rule will be adopted without amending the rule to fit within the broader legal framework of the adopting country. A functional equivalent may not necessarily fit into a broader domestic legal system, and this raises the possibility that traditional functionalism is too focused on the comparison of national jurisdictions.[131] I submit that this is where the recommendation of an international or regional organisation is of value as the intention is that the recommendations from these bodies be tailored to fit into the broader national legal framework of the adopting country – become fit-to-context.

Yet another objection is that the assumption of the universality of legal problems (or universal values) across jurisdictions may be flawed.[132] In response to the formulation of the functional method by Zweigert and Kötz, the comparison can only take place where the jurisdictions compared arrive at the same result (outcome).[133] The modern functional approach should consider a balance between the similarities and divergence between legal systems. Also, I argue that if reaching the same outcome is to be used as the common comparator, then surely fewer legal comparative studies will be able to take place.

The criticism against or the limitation in using a traditional functional method must not result in the rejection of the functional approach altogether. The better approach is to adapt the traditional functional method, in part to address the criticism against it, but more importantly to create a modern and workable equivalent – in essence 'rethinking what we want to achieve with the functional method'.[134] Therefore, achieving neutrality in creating comparability is possible. The options which result from the comparison are then evaluated against the knowledge of the comparatist's domestic legal jurisdiction and the purpose of this specific research. It is correct, then, that the functional method is merely a tool to provide the researcher with comparable options.

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130 J De Coninck 'The functional method of comparative law: "quo vadis" ?' (2010) 74 *The Rabel Journal of Comparative and International Private Law* 318 at 326.

131 JM Smits 'Taking functionalism seriously: on the bright future of a contested method' (2011) 18 *Maastricht J Eur & Comp L* 554 at 556.

132 J De Coninck 'The functional method of comparative law: "quo vadis" ?' (2010) 74 *The Rabel Journal of Comparative and International Private Law* 318 at 329.

133 JM Smits 'Taking functionalism seriously: on the bright future of a contested method' (2011) 18 *Maastricht J Eur & Comp L* 554 at 556, 557.

134 JM Smits 'Taking functionalism seriously: on the bright future of a contested method' (2011) 18 *Maastricht J Eur & Comp L* 554 at 555.

1.5.2.3 The modern functional comparative law approach applied

The traditional functional comparative law approach is not a good fit when it comes to comparing property law systems,[135] but I submit that there is a place for a modern functional comparative law approach. The purpose of a modern functional comparative law approach is to point to possible solutions and not necessarily prescribe which of those solution would be best. This modern approach provides a criterion for comparison.[136]

However, it remains important to quantify exactly which types of comparative study are suited to the use of a variation of this type of method. Further, the basic elements which form part of the functional method should be clarified. For example, the traditional functional method did not allow for a vertical comparison and this should not apply in a modern functional comparative approach.[137] It must also be possible to use this method for both normative and descriptive research.[138] This calls for a modern and workable functional approach.

The modern functional comparative-law approach involves identifying the policies, principles, ground rules, and other technical rules of a property law system.[139] The assumption is that there is a similarity (or convergence) between the policies, principles, and ground rules of all property law systems.[140] However, the divergence emerges in the technical rules, arguably as a result of the historical divergence between property-law systems.[141] These elements then provide a common comparative denominator (*tertium comparitionis*) meaning qualities that two or more property law systems have in common and that allow comparison

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135 J Husa 'Functional method in comparative law–much ado about nothing?' (2013) 2 *EPLJ* 4 at 16 and the reference to the source at n 50. See also JM Smits 'Taking functionalism seriously: on the bright future of a contested method' (2011) 18 *Maastricht J Eur & Comp L* 554 at 554-558.

136 R Michaels 'The functional method of comparative law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 381.

137 B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 116-117.

138 B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 97.

139 B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 109-110 and B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 9 availabe at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2394056 (date of access: 24 January 2017).

140 The application of the functional approach is clear in the assumption that a similar fundamental principle or ground rule performs a specific function. How this function is performed may then be different as a result of the divergence between the technical rules, which have a specific historic connection. See B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 96, 109, and S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1050, 1051 where the author does not mention the functional comparative approach *per se* but refers to the possibility of convergence in the manner.

141 S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1044.

between the systems (or frameworks). There is broad consensus regarding the fundamental principles as well as ground rules that form the foundation of most property law frameworks.[142]

Another supra-level policy was added to the initial dichotomy by including 'policy choices' in addition to the fundamental principles, ultimately resulting in a new property law theory.[143] This adds a normative element[144] which is needed where the comparatist attempts not only horizontal, but also vertical comparison.[145] In simple terms this means discovering a common frame of reference (ie, a normative standard) that consist of universally recognised fundamental principles and ground rules against which the fundamental principles and ground rules of a *national* property law system can be measured.[146] The common frame of reference is established by identifying the similarities and divergence between the key policy objectives and fundamental principles extracted from various soft-law instruments the researcher included as part of her study.

In conclusion, the modern functional comparative law approach is not suited to all forms of comparative research, but it is suited to this study. The method creates comparability between key policy objectives and fundamental principles (or policies) that form part of the international,[147] regional,[148] and domestic secured transactions legal frameworks. Consequently, both horizontal and vertical comparison of laws becomes possible. Presented with possible solutions, I shall then be able to evaluate those options (elements of the proposed framework) using criteria for evaluation that do not necessarily form part of the functional approach as such, but that are informed by my understanding of the South African real security law framework.[149] This approach to law reform will arguably also strike the appropriate

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142 S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1050.

143 See the synopsis of Van Erp's approach by B Akkermans 'The use of the functional method in European Union property law'' (2013) 2 *EPLJ* 95 at 110 and B Akkermans 'The comparative method in property law' *Maastricht European Private Law Institute Working Paper* 2014/7 at 9 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2394056 (date of access: 24 January 2017). This approach is also the intended approach of the UNCITRAL Guide.

144 JM Smits 'Taking functionalism seriously: on the bright future of a contested method' (2011) 18 *Maastricht J Eur & Comp L* 554 at 557 where the lack of a normative element of the traditional functional method is criticised and the addition of a normative consequence recommended to reshape the traditional method (at 558).

145 See B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 114-115 who explains the normative contra to a descriptive nature of the EU functionalist approach as an attack on the plurality amongst national legal systems.

146 B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 110.

147 The outcome of Chapter 3 *infra*.

148 The outcome of Chapter 4 *infra*.

149 Discussed in Chapter 5 *infra*.

balance that should exist between a functional and a historico-legal comparative analysis.[150] The historico-legal analysis is found in an investigation of the fundamental principles of South African property law. Consequently, this study contributes to the development of a renewed (or modern) functional method (or approach). As Smits asserts, a modern functional method can only develop if the comparatist goes through an actual process of comparison to determine the viability of the method (approach),[151] so linking to the *how*-question posed above. The substance of a functional comparative law approach is, therefore, reliant on what the researcher wished to achieve by using the modern functional approach.

1.6 Conclusion

The central assumption of this study is that the current South African real security law framework for movable property should reform if it is to become effective. This reform must consider that a framework is only legally efficient when it is also commercially effective. Before deciding whether the South African law reform should follow either a piecemeal or a wholesale reform approach, specific elements (or concepts) of the existing framework must be analysed. This, in turn, allows the key policy objectives and fundamental principles of the proposed legal framework to be identified. In order to draw inspiration for the intended law reform, the methodological foundation which allows for a vertical comparison must be identified and adapted, not only to correspond to the modern commercial reality of how the law should operate, but also to take account of how to integrate the important elements of the existing South African legal framework. To achieve this, a modern adaptation of the functional comparative approach is best suited. With this adapted method, the key policy objectives and fundamental principles in different legal instruments are first identified. Then, it is established which of these key objectives and fundamental principles make a legal framework effective. The assumption is that incorporating the sample of key policy objectives and fundamental principles will result in a hypothetical 'effective' framework. The vertical comparison for this study is grounded in the UNCITRAL instruments, discussed in Chapter 3, as well as specific regional instruments related to secured transactions law which form the topic of Chapter 4. However, as the substance of this study is centred on the current South African real security

150 S van Erp 'Civil and common property law: caveat comparator–the value of legal historical-comparative analysis' (2003) 3 *Eur Rev Priv Law* 394 at 409.

151 JM Smits 'Taking functionalism seriously: on the bright future of a contested method' (2011) 18 *Maastricht J Eur & Comp L* at 554, 558.

law framework, the fundamental principles and ground rules that form part of this framework are discussed in the following chapter of this research, Chapter 2.

Secured transactions law is a dynamic field and new literature concerning the topic is continuously released. Accordingly, this thesis only includes those references available as at 31 October 2019.

CHAPTER 2
THE SOUTH AFRICAN REAL SECURITY LAW FRAMEWORK

2.1 Introduction

The South African legal framework governing security rights in movable property should be regarded as ineffective. As mentioned in Chapter 1, a legal framework is regarded as effective where it is legally efficient.[1] Accordingly, the elements making up the South African legal framework must be analysed to establish which, if any, render the framework ineffective. This chapter, therefore, studies the South African legal framework for security rights in corporeal movable property.[2] Chapter 1 speculated on possible reasons why the South African framework could be regarded as ineffective, and this chapter expands on those reasons.[3]

The first section of this chapter provides the contextual perspective to understanding the foundation of the current legal framework. This discussion includes previous law reform initiatives, and a synopsis of the types of express, contractually-created, real security known to South African law. The general principles relevant to the creation of a real security right are considered, followed by the final aspect – a contextual discussion of the fundamental principles and ground rules (including technical rules) which underpin our current real security law framework.

The second part of the chapter involves an exposition of two categories of security in corporeal movable property under the current South African real security law framework: possessory pledges,[4] and notarial bonds. The chapter further includes a discussion of certain title-based security devices, regarded as *quasi*-security under the South African framework. The discussion of the three categories of security device extends to a brief review of the historical development of each category, followed by a description of the specific elements of

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1 See the discussion of the meaning of legal efficiency in Chapter 1 paragraph 1.2 *supra*.

2 The reference to the 'real security law framework' would not be entirely correct as certain title-based security devices, examples of *quasi*-security, are included as part of this study. Accordingly, to be inclusive the general reference to 'security rights in movable property' is used.

3 See Chapter 1 at paragraph 1.1 *supra*.

4 The focus of this study is on corporeal movable property. However, some discussion of certain types of incorporeal movable property is included under the discussion of cession *in securitatem debiti* of certain incorporeal movable property.

each device. These elements link to the elements of a legal framework detailed in Chapter 1.[5] The representation of the legal nature of each security right will ultimately determine in what respects the combined South African legal framework for security rights in movable property is ineffective. Consequently, *this* chapter does not aim to make recommendations regarding the reform of the South African framework. The purpose is to identify those elements which render the South African framework ineffective. The aspects identified as contributing to the South African framework not operating effectively are revisited in Chapter 5 where the recommendations for possible reform are made.

2.2 Evolution towards reforming the current real security law framework

The only notable reform initiative in the previous two decades or so has been the adoption of the Security by Means of Movable Property Act.[6] Despite the SMPA introducing a non-possessory security device, South Africa still does not have a legally *efficient* non-possessory security device.[7] This absence of more robust reform is strange, especially when compared to the global impetus to reform secured transactions law. The short answer to this lack in South Africa is that reforming the law requires the political will to do so.[8] In the case of secured transactions law, politicians must be convinced that modernisation will result in economic growth.[9] Therefore, the commercial sector arguably would have to lobby the South African government to reform this area of law, using as the 'carrot' that reforming the legal framework will result in economic growth for South Africa.

As far back as the late 1980s, the South African Law Commission (SALC), as it then was,[10] called for substantial reform of the real security law framework.[11] The SALC's

5 See Chapter 1 paragraph 1.4 *supra*.

6 Act 57 of 1993 (the SMPA). The Act came into operation on 7 May 1993. See GN 783 in *GG* 14786 of 7 May 1993.

7 JC Sonnekus '*Constitutum possessorium* en die oordrag van saaklike regte' 1979 *TSAR* 41 at 41.

8 According to CG Van der Merwe & LD Smith 'Financing the purchase of stock by the transfer of ownership as security: a simulated transaction' (1999) 10 *Stell L Rev* 303 at 325, evidence from other jurisdictions shows that the fact that reform is needed, does not necessarily result in this reform taking place. There must be political will to enact a specific law. See also R Cranston 'Theorizing transnational commercial law' (2007) 42 *Tex Int'l LJ* 597 at 600.

9 F Dahan & J Simpson 'Legal efficiency for secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson *Secured Transactions Reform and Access to Credit* (2008) at 125. See the discussion in Chapter 1 paragraph 1.2 *supra* on the link between the economic benefit associated with a secured transactions law framework and legal efficiency.

10 The name of the South African Law Commission was changed to the South African Law Reform Commission in terms of ss 8 and 9 of the Judicial Matters Amendment Act 55 of 2002 subsequent to this report. However, further reference to this report in this thesis refers to the former name of the commission.

11 See the South African Law Commission Discussion Paper 23 (Project 46) 'Sekerheidstelling deur middel van roerende goed' (1987) (SALC discussion paper). This was followed by SALC report.

discussion paper contained a draft bill recommending two types of non-possessory pledge: (1) a non-possessory pledge requiring no registration in clause 1 of the Bill; and (2) a non-possessory pledge which required registration under clause 2 (the special notarial bond currently known in South African law). Unfortunately, the first type of non-possessory security device shifted the scales in favour of commercial needs rather than security, completely disregarding the publicity principle in the process.[12] The drafters of the Bill attempted to keep some form, albeit inadequate, of the publicity requirement. It was argued that the mere fact of having a *written* pledge agreement, satisfied the publicity requirement. The content of the agreement would have had to be communicated to the successor in title. It is unclear how this suggested construction could have succeeded in fulfilling the true purpose of 'adequate' publicity, as the agreement applied *inter partes* and third parties were therefore not privy to its content. Further, this non-possessory pledge would only become real security on the insolvency of the debtor. Where the debtor gave the same asset as security to a second creditor, the first creditor would be unable to pursue the asset in the hands of the second creditor. Clause 1 of the draft Bill, therefore, contained no workable solution that would be both acceptable to commerce and maintain the fundamental principles of South African property law. With good reason, the non-possessory security device without publicity was not included in the Bill proposed in the SALC report which followed the SALC discussion paper.[13]

The SMPA was adopted in 1993, mainly as a result of the Appellate Division, as it then was,[14] 'bursting the bubble' in the decision in *Cooper v Die Meester*.[15] As a discussion of the *Cooper* judgment requires an understanding of the legal nature of notarial bonds, the details of the judgment are reserved for the paragraph dealing with notarial bonds *infra*.[16] Another reform initiative in the broader consumer credit law context which should be noted, is the adoption of the National Credit Act[17] in 2005. The main purpose of the NCA relates to consumer credit

12 J Scott 'Sekerheidstelling deur middel van roerende goed: die finale woord' (1989) 22 *De Jure* 119 at 122.
13 Annexure C to the SALC report at 143-160.
14 The name has been changed to the Supreme Court of Appeal.
15 1992 (3) SA 60 (A) (the *Cooper* judgment). For a discussion of this judgment see P deW Van der Spuy 'Spesiale notariële verband oor roerende sake−geen preferensie by insolvensie van verbandgewer' (1992) 25 *De Jure* 486 at 486-496; and JC Sonnekus 'The correlation between the requirements for and content of a real agreement and meaningful real security rights in a financial crisis' 2012 *TSAR* 670 at 688, and JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 113. According to S Scott 'Notarial bonds and insolvency' (1995) 58 *THRHR* at 683, it was unfortunate that the *Cooper* judgment required the 'hasty introduction' of the Act. The *Cooper* judgment was confirmed in *Sentraalwes (Koöp) Bpk v Die Meester* 1992 (3) SA 86 (A). The concern regarding the hasty introduction is shared by C van der Walt, G Pienaar & C Louw 'Sekerheidstelling deur middel van roerende goed–nog steeds onsekerheid!' (1994) 57 *THRHR* 614 at 614.
16 See paragraph 2.5.3 *infra*.
17 34 of 2005 (NCA).

law, which falls outside the scope of this thesis save to the extent to which it may impact on the conceptual features of the current security rights (such as the enforcement proceedings).

Before the legal nature of the specific security devices can be discussed, the contextual foundation for the real security law framework is provided. This includes an introduction to the general legal nature of real security rights, followed by an introductory discussion of the fundamental principles and ground rules (including technical rules) that form part of the South African real security law framework. The fundamental principles are discussed for two reasons: first, to link to the methodological foundation of this study;[18] and second, to inform the discussion of the legal nature of the security devices *infra*.

2.3 Real security rights applicable to movable property

2.3.1 Context

In general, a debtor may either provide personal security (a person agrees to perform a contractual obligation) or agree that if she defaults the proceeds from her assets may be used to satisfy the creditor's claim and enjoy priority above other creditors' claims (providing a real security right in the debtor's assets or the assets of someone acting on behalf of the debtor).[19] It is also possible that the security may be granted by a party other than the debtor. The law of property is divided into the law of things (real rights) and the law of obligations (personal rights).[20] The focus of this study is on the real security right in the debtor's movable property.

A real security right was a familiar concept in Roman law, and the foundation of the South African real security law is based on Roman law introduced to South Africa through the incorporation of Roman-Dutch law into South African law.[21] South African courts and the legislature then developed the Roman-Dutch law principles that form part of the current South African real security law framework.[22] Certain security concepts known to Roman law, correspond to existing modern security devices.[23] The first of these is *manicipatio cum fiducia.* This device vested the creditor with both ownership and possession, subject to a personal

18 See Chapter 1 paragraphs 1.3 and 1.5 *supra*.
19 R Sharrock *Business Transactions Law* (9th ed 2017) at 787.
20 CG van der Merwe 'Things' in WA Joubert & JA Faris (eds) *LAWSA* Vol 27 (2nd ed 2014) para 59.
21 R Brits *Real Security Law* (2016) at 12.
22 R Brits *Real Security Law* (2016) at 12.
23 RJ Goebel 'Reconstructing the Roman law of real security' (1961) 36 *Tul L Rev* 29 at 30.

obligation to reconvey possession to the debtor once the debt had been settled.[24] The second concept is *in iure cessio cum fiducia*. With this device, the debtor transferred ownership to the creditor but retained possession.[25] Another concept was that of *pignus* where the debtor retained ownership, but transferred possession to the creditor until the full debt had been paid.[26] The *pignus* was known to both Roman law – in the main in the agricultural sector[27] – and Roman-Dutch law where possession of the movable property was delivered to the creditor.[28] It carried a wide meaning in that it covered all forms of limited real right in another's asset.[29] The last concept was the *hypotheca* in terms of which the debtor retained both ownership and possession of the property.[30] The *hypotheca* was basically a contractually-created security right which did not require the transfer of control or possession to the creditor.[31] The first two concepts – collectively referred to as *fiducia* – did not survive, leaving only the *pignus* and *hypotheca* under Justinian Roman law.[32] In South African law, too, the distinction between a mortgage (or hypothec) and a pledge remain part of the current real security law framework.[33] This study steers clear of: (1) further historical discussion apart from acknowledging the existence of historically recognised security devices resembling our current security devices; and (2) the doctrinal distinction between the meaning of pledge and mortgage under South African law. The approach in this study is more practical and elects to phrase the discussion in

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24 Essentially the debtor would then lease the property from the creditor to enable the creditor to use the property.

25 This is similar to using ownership as security.

26 This is similar to the common-law pledge. However, in Roman law, the *pignus* could extend over both movable and immovable property. Further, there is some authority for the view that the distinction between the *pignus* and *hypotheca* was not really that clear-cut. A *pignus* may as well have related to a non-possessory pledge as creditors often left the asset in the debtor's possession. See WJ Zwalve 'A labyrinth of creditors: a short introduction to the history of security interests in goods' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 41-42.

26 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 47, 48.

27 R van den Bergh 'The development of the landlord's hypothec' (2009) 15 *Fundamina* 155 at 157. See also TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 3.

28 See TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 3 and 4 and the references to Grotius, Voet, and Huber.

29 GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 406.

30 This is similar to a non-possessory pledge the name of which originated with the Greeks, but the content has Roman roots. See RJ Goebel 'Reconstructing the Roman law of real security' (1961) 36 *Tul L Rev* 29 at 35-36. This device developed to address a need in the agricultural sector and could vest in both movable and immovable property.

31 R Brits *Real Security Law* (2016) at 12.

32 WJ Zwalve 'A labyrinth of creditors: a short introduction to the history of security interests in goods' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 39.

33 R Brits *Real Security Law* (2016) at 13.

terms of: (1) the distinction between possessory and non-possessory real security; and (2) using the 'labels' for security devices generally used in South African practice.[34]

Both real rights and limited real rights are patrimonial rights recognised in South African property law.[35] Other patrimonial rights include a personal right, which is a right to performance against another person (but not against her assets);[36] an immaterial property right, which is a right to immaterial property; a special type of personal right created in a contract recognised by statute; and a statutory right against the state to certain resources and performances.[37] A property right is distinguished from a personal right by its having a certain proprietary effect. Consequently, a real security right is created in an *asset* of the person providing the security[38] and is an absolute right which applies *erga omnes* – ie, against the world at large.[39] Conversely, a personal right is a right against a *person*, not her property.[40] Also relevant is the informal classification of *quasi*-real security rights afforded to retention-of-title and other title-based security devices which will, for the most part, qualify as a personal right created by contract. The reference to *quasi*-real security rights reflects that these rights fulfil the same economic function as a proper security right and can loosely be referred to as functional securities.[41] *Quasi*-real security rights are discussed in greater detail *infra* under the paragraph dealing with title-based security devices.[42]

A real right can be either an unrestricted or absolute right (as with ownership),[43] or may be limited, where the owner can only use her asset subject to the limitation imposed by the limited real right (as with a pledge or a mortgage).[44] Accordingly, a limited real right is a secondary right[45] – a right relating to property owned by another[46] – a right *in rem*.[47] The holder

34 Indeed, this approach is also followed by Brits in R Brits *Real Security Law* (2016) at 13.
35 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 23.
36 Performance means either a negative or positive obligation required from a person by another. See PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 23.
37 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 24.
38 The debtor need not necessarily own the collateral. A third party may also use its property to secure the debtor's debt.
39 R Brits *Real Security Law* (2016) at 3 and S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1051, 1052.
40 R Brits *Real Security Law* (2016) at 2.
41 H Beale *et al The Law of Security and Title-based Finance* (3rd ed 2018) at 261 and G Pienaar & AJM Steven 'Rights in security' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 760.
42 See paragraph 2.6 *infra*.
43 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 23.
44 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 23, 47.
45 Something less than the right of ownership.
46 R Brits *Real Security Law* (2016) at 3, 4.
47 Also referred to as a *ius in re aliena.*

of the right may take possession of the relevant property in the case of perfection, and dispose of the movable property when the debtor is in default. The general rule is that the secured creditor does not acquire the use and enjoyment of the property. Nevertheless, the parties may conclude a *pactum antichreseos* which allows the creditor to enjoy and collect the fruits of the property subject to the value being set-off against the interest payable on the principal obligation.[48]

A real security right originates either through an agreement[49] or by operation of law.[50] However, under South African law, a consensually created real security right is not created merely by concluding a contract;[51] an additional and separate constitutive action, broadcasting the existence of the right to third parties, must take place before the real security right is created. Two agreements, the loan agreement and the real agreement, contain the manifestation of the intention of parties to create a specific limited real right. The general method for creating consensual real security rights is explored in the next paragraph.

2.3.2 Creation of a real security right in movable property

Consensually-created real security rights are created through separate actions. First, a loan agreement must be concluded, coupled with an external act which gives effect to the provisions of the loan agreement.[52] In turn, the external act consists of: (1) the conclusion of the real agreement; and (2) the publicity of the real security right.[53] The parties must share the intention that they wish to create a personal obligation between them. This intention is evidenced by the provisions of the loan agreement. This second agreement, the real agreement, can only exist subject to the conclusion of a loan agreement. Consequently, the real security is *accessory* to the underlying debt.[54] The external act does not complete the loan agreement; it 'gives effect

48 R Brits *Real Security Law* (2016) at 142-145, 217, 329.

49 This includes real security in the form of pledges, mortgages, notarial bonds, and cession *in securitatem debiti.* Also see PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 403.

50 Only the former falls within the scope of this study. Examples of the latter include, tacit hypothecs of the landlord and credit grantor, judicial pledges, statutory security rights, and liens.

51 As was the case under the UNCITRAL Guide and UNCITRAL Model Law (see Chapter 3 at paragraph 3.3.3.5 *infra*) and the OAS Model Law (see Chapter 4 paragraph 4.3.3.3 *infra*).

52 R Brits *Real Security Law* (2016) at 4, 5. See also S Scott 'Aard en rol van notariële verbandakte' 2005 *TSAR* 842 at 846.

53 Either through registration or delivery of possession or control.

54 See S Scott 'Aard en rol van notariële verbandakte' 2005 *TSAR* 842 at 846 and *Kilburn v Estate Kilburn* 1931 AD 501 at 506 and *Thienhaus v Metje & Ziegler Ltd* 1965 (3) SA 25 (A) at 32F-G confirming that a proprietary right cannot exist separately from the principal obligation. See paragraph 2.3.3.3(*a*) *infra*.

to it'.[55] The loan agreements create the personal obligation to perform and performance of the obligation then takes place through the external action.

The real agreement sets out the terms on which the real security right is taken.[56] This is the subjective element or *traditio. Traditio* involves the shared intention of the parties respectively to transfer and receive the real security right. There are no general requirements as regards the format of a real agreement.[57] However, the publicity requirements – legislative or otherwise – may inform the format of the real agreement. The real agreement requires the consent of both parties and must sufficiently indicate the intention of the parties to create a *specific* real security device.[58] However, the court will pay attention to the true substance or nature of the security device described in the real agreement, irrespective of the label the parties assign to it.[59] The unfortunate outcome is that the court might label the agreement differently from the real security device intended by the parties.[60]

The publicity-forming element of the additional action gives effect to the provisions of the agreements. Publicity is achieved either through the transfer of possession (or control),[61] or by a form of registration.[62] This action is the objective element required to broadcast the existence of the limited real right to third parties.[63] 'Perfection'[64] of the limited real right entails that the creditor may exercise the right against third parties. In simple terms, this proprietary security right is enforceable *erga omnes*, meaning specifically against those parties who make a claim either against the asset or its resulting proceeds.[65] Due to the *erga omnes* enforceability

55 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 72.

56 See *Air-Kel (Edms) Bpk H/A Merkel Motors v Bodenstein* 1980 (3) SA 917 (A)(the *Air-Kel* judgment) at 922F_where the term 'saaklike ooreenkoms' ('real agreement') was recognised. See also R Brits *Real Security Law* (2016) at 5 for mention of this term. The equivalent term would be a 'security agreement' within the context of secured transactions law.

57 It is possible to conclude a verbal pledge agreement so creating room for some uncertainty on the exact terms of the agreement. The lack of prescribed format differs from the detailed requirements in other legal frameworks (eg, see recommendation 14 of the UNCITRAL Guide).

58 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 41.

59 See *Zandberg v Van Zijl* 1910 AD 302 (the *Zandberg* judgment) at 309. See also the discussion of simulated transactions in paragraph 2.6.1.1 *infra*.

60 This unfortunate outcome could be avoided where 'substance over form' under the functional approach applies. See Chapter 3 paragraph 3.3.3.2 *infra* where the functional approach is explained.

61 The UNCITRAL Guide distinguishes between control and possession. This is revisited in Chapter 3 *infra*.

62 For the real security in the form of a registered special notarial bond. This is an example of transaction (or document) filing contra to notice-filing discussed in Chapter 3 para 2.5.6.

63 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 83.

64 'Perfection' refers to the moment at which the real right of security is constituted under South African law. See S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 659, 660.

65 R Brits *Real Security Law* (2016) at 3.

of the property right, there must be sufficient transparency as regards the existence of the real right.

Publicity does not in itself create a limited real right; it is rather the physical expression of the intention expressed in the real agreement, making it also the point at which the limited real right is successfully constituted and thus effective against all third parties.[66] Along with specificity as regards the asset and, on occasion, the debt description, publicity results in transparency[67] – a fundamental principle of the real security framework. The fundamental principles of the South African framework are discussed *infra*.

2.3.3 Fundamental principles and ground rules of the South African framework

Arguably, property law systems share the same (or at least similar) principles and ground rules, but the technical rules may differ between property law systems.[68] In general, the fundamental principles that form the foundation of the legal framework for security rights should result in 'certainty and predictability' for all parties.[69] The two fundamental principles of traditional property law are the *numerus clausus* doctrine and the transparency principle. Transparency, in turn, requires specificity in the description of the property (and the secured obligation in some legal frameworks) followed by the publicity of the real right (or security right).[70]

Equally important are certain ground rules and technical rules which form part of South African property law.[71] These include: the accessory relationship between the security and the indebtedness; the *nemo plus iuris transferre potest quam ipse habet* rule; the *priore tempore potior iure* rule; the prohibition of a *pactum commissorium*; the maxim *mobilia non habent sequelam ex causa hypothecae*; the prohibition of self-help when the security right is enforced; and the technical rules concerning the abstract or causal theory of the transfer of real rights.

66 R Brits *Real Security Law* (2016) at 6.

67 R Brits *Real Security Law* (2016) at 5. See JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 110, 137.

68 B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 109 refers to the introduction by Van Erp during a Van Gerven Lecture in 2006, entitled 'European and National Property Law: Osmosis or Growing Antagonism'. See also S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1050, for a discussion of this dichotomy of terminology of a property law system suggested by Van Erp.

69 JM Milo 'Property and real rights' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 726.

70 S van Erp 'Contract and property law: distinct, but not separate' (2013) 2 *EPLJ* 241 at 247. See also JM Milo 'Property and real rights' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 726 who mentions these principles.

71 It is possible that some of the rules listed are more technical and assist to realise the ground rule.

The discussion of the fundamental principles and ground rules below also refers to how these principles and rules could impact future legal reform. It has been mentioned before that identifying those fundamental principles, ground rules, and technical rules of a legal system, allows the application of a modern functional approach to a comparative study of legal systems (or frameworks).[72] This means that the discussion of these principles and rules provides the methodological foundation for the rest of this chapter.

The decision on which fundamental principles and ground rules should continue to apply to a reformed South African legal framework, depends on the policy choices underlying current and future laws.[73] This harks back to the discussions in Chapter 1 regarding the role of key policy objectives, fundamental principles, and ground rules in the legal reform process,[74] which is the foundation for the modern functional comparative approach applied in this study.

2.3.3.1 Fundamental principle: transparency

A real right is an absolute right and has an *erga omnes* effect (it is enforceable against the world).[75] Consequently, to allow for transparency of a real right, third parties must be able to identify the object of a right (specificity), and the existence of this right must be visible to third parties (publicity).[76] Transparency fulfils an important role in both civil and common law.[77] Accordingly, transparency must remain a key policy objective for future legal reform. However, different legal systems potentially interpret what the transparency principle *currently* entails differently, which causes a deviation in how this principle is incorporated as part of each legal framework. This divergence may manifest in the technical rules of a legal system as to how the fundamental principle is implemented. One example is a possible trade-off in a legal system in terms of which the required level of transparency is reduced in order to make it possible for the pool of collateral available for use as security to be increased.[78] Another

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72 See Chapter 1 paragraph 1.5.2.3 *supra*.

73 S van Erp 'Contract and property law: distinct, but not separate' (2013) 2 *EPLJ* 241 at 247.

74 See the discussions of key policy objectives and fundamental principles in Chapter 1 paragraph 1.3 *supra*; Chapter 3 paragraphs 3.3.2 and 3.3.3 *infra* (UNCITRAL discussion); Chapter 4 paragraphs 4.2.2 (referred to as the EBRD Core Principles) and 4.2.3.2 (EBRD Model Law) *infra*; and Chapter 4 paragraphs 4.3.2 and 4.3.3 (OAS Model Law) *infra*.

75 S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1051.

76 S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1060.

77 S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1060.

78 Chapter 5 paragraph 5.3.5 *infra* discusses this trade-off.

example concerns the lack of publicity (and thus transparency) where retention-of-title is used to secure a debt. The reservation of ownership under the retention-of-title provides the best legal protection to the seller, but there is a trade-off against the lack of transparency in this type of security which does not require registration. Essentially, future reform needs to consider the extent of the trade-off that needs to take place in the application of different principles, ground rules, and technical rules, ultimately to deliver a legally efficient legal framework.

As mentioned, transparency includes the publicity of the security right and then the specificity of certain details. Publicity is not, in itself, sufficient to result in complete transparency in respect of the security right and certain degree of specificity regarding the hypothecated property is also required. Each principle is discussed separately *infra*.

(a) Publicity

The publicity principle is central to the South African real security law framework. However, certain legal jurisdictions appear to pay less attention to the importance of publicity.[79] The principle originated in Roman-Dutch law and relied on the premise *traditionibus et usucapionibus dominie rerum, non nudis pactis transferuntur*.[80] Accordingly, where the legal position of a party has changed as regards the rights held in a property, it is not enough that the change is evidenced only in an agreement; it must also be expressed in public. Therefore, publicity is focused on publicising the legal effect of a real agreement for the benefit of third parties.[81] This notwithstanding, the real right is not created solely by publicity.[82] Publicity is rooted in the fact that a property right may only affect third-party rights if the right is also

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79 Germany has a registration-less system which only works because Germany has a closed credit market which is controlled by a few, well-informed, key role players. See G McCormack 'American private law writ large? The UNCITRAL Secured Transactions Guide' (2011) 60 *Int'l & Comp LQ* 597 at 613. Publicity is also not essential for effective proprietary rights under the Dutch Civil Code, see JH Dalhuisen 'European private law: moving from a closed to an open system of proprietary rights' (2001) 5 *Edin LR* 272 at 287 where the author refers to art 237 of the Dutch Civil Code. Austria also has no public notice system. See DJY Hamwijk *Publicity in Secured Transactions Law: Towards a European Public Notice Filing System for Non-Possessory Security Rights* (2014) (published LLD-thesis: Universiteit van Amsterdam) at 17.

80 The maxim translates as a change in the legal position of the real right cannot only result from an agreement.

81 JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 117.

82 As was clearly illustrated in the *Cooper* judgment where even though it was a duly registered special notarial bond, the law at the time did not provide for the creation of a non-possessory security, making publicity through registration irrelevant. See JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 134.

publicly known.[83] In short, publicity attempts to align the factual position with the legal position to avoid misleading third parties;[84] it broadcasts the link which exists in law between the burdened object and the principal debt.[85]

More specifically, within the context of insolvency, publicity ensures that creditors can establish the actual creditworthiness of the debtor.[86] It alerts third parties that the debtor is no longer in a position to deal with her assets as she pleases,[87] and informs potential and existing creditors that the debtor now has less unencumbered property to offer as possible security.[88] Publicity is also linked to the determination of priority in that the public notice must clearly reflect the order of priority for the distribution of the proceeds resulting from the implementation of execution measures.[89]

Publicity generally occurs either through the transfer of possession (or control), or through a form of registration – either notice-based filing[90] or transaction-based filing. Notice-based filing merely serves as a warning of a potential security right. It can, therefore, be argued that this type of registration pursues a purpose other than the traditional function of publicity.[91] Transaction-based filing is more cumbersome than notice-based filing. In the case of transaction filing, the details of the secured transactions are registered in a public registry which means that, as a rule, both the creation and third-party effect of the security right usually happen

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83 DJY Hamwijk 'The puzzling concepts of publicity and possession: to the heart of property law' (2012) 1 *EPLJ* 299 at 300. Also, see DJY Hamwijk *Publicity in Secured Transactions Law: Towards a European Public Notice Filing System for Non-Possessory Security Rights* (2014) (published LLD-thesis: Universiteit van Amsterdam) at 35.

84 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 392, and the SALC report at 12.

85 S Scott 'Aard en rol van notariële verbandakte' 2005 *TSAR* 842 at 847.

86 N Strydom *Die Aksessoriteitsbeginsel in die Suid-Afrikaanse reg'* (2000) (unpublished LLM-dissertation: Rand Afrikaans University) at 87, which is referred to with approval by S Scott 'Aard en rol van notariële verbandakte' 2005 *TSAR* 842 at 846 and 847.

87 JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 118.

88 DW Arner *et al* 'Property rights, collateral, creditor rights and financial development' 2006 *Eur Bus L Rev* 1215 at 1236. A real right is after all an absolute right against third parties and need to be advertised as such. See SALC report at 1. See also E Dirix 'The new Belgian Act on security interests in movable property' (2014) 23 *Int Insolv Rev* 171 at 173.

89 DW Arner *et al* 'Property rights, collateral, creditor rights and financial development' 2006 *Eur Bus L Rev* 1215 at 1236. See also JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 111 and 117 stating that true priority for a creditor originates from the correct application of publicity principle.

90 P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 633 suggests a notice-filing system for South Africa.

91 Notice-filing is used in the UCC Article 9 and the personal property security acts (PPSA) which follow article 9. Notice-filing is also suggested under the UNCITAL instruments discussed in Chapter 3 paragraph 3.3.3.6 *infra*.

simultaneously. But not all jurisdictions follow this general rule.[92] The registration of notarial bonds in the South African framework is an example of transaction filing – albeit with notarial involvement – where the creation and third-party effectiveness take place simultaneously. Even though a form of registration is the publicity method of choice, possession or transfer of control should remain a publicity method, but only as secondary to registration and limited to specific types of asset.[93] Reform should place sufficient emphasis on how *effective* publicity is achieved.[94] *Effective* publicity demands consideration of current commercial reality. Account must be had of the current or modern purpose of publicity: does it mere alert to the possibility of a right, or is it conclusive proof that the security right exists?[95]

Linked to publicity is the provision of sufficient information about the asset and principal obligation in the public domain. It is here where the specificity principle – the topic of the next paragraph – comes into play.

(b) Specificity in the property description

Specificity is linked to the publicity principle discussed above. Transparency requires that the security object (and in some frameworks also the secured debt) is strictly defined. This is the basis for the principle of specificity.[96] The encumbered assets must be described with a certain amount of specificity, first in the real agreement, but also in the registered notice (or registered document). The 'specificity principle' developed in certain European countries, where a special type of security right received preferential treatment above a general security right. This preference was based on a more detailed asset description.[97]

The required degree of specificity depends on the requirements set for the security device used. Specificity is an essential aspect of the asset description requirement for special notarial bonds under the SMPA.[98] The general principle may, however, also relate to other elements

92 This was the approach introduced by the Belgian Pledge Act of 11 July 2013. See E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 247. Transaction-filing is used but there is a clear separation between when the security right is created and when the right becomes effective against a third party.

93 For example, letters of credit require transfer of control.

94 JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 119.

95 This links to the extent which a due diligence process is included as part of the legal framework.

96 S van Erp 'Civil and common property law: caveat comparator–the value of legal historical-comparative analysis' (2003) 3 *Eur Rev Priv Law* 394 at 403.

97 WJ Zwalve 'A labyrinth of creditors: a short introduction to the history of security interests in goods' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 44.

98 See paragraph 2.5.4.2 *infra*.

that must be described in the real agreement with a certain degree of specificity – eg, the description of the principal obligation. Currently, there is no provision under South African law requiring that, in addition to having been stipulated in the loan agreement, the principal debt be included in the real agreement.[99] However, including a standard for describing the secured obligation is recommended.[100]

The purpose of asset-description specificity is to 'give notice to the general public, of the movables specially hypothecated under the bond'.[101] Third parties reading the real agreement must be able to identify the security object without consulting extrinsic evidence.[102] The theory is that the adequate identification of a specific asset is required to establish its proprietary effect.[103]

A middle-ground must be found between having a strict specificity requirement and allowing flexibility in the asset description. When the specificity principle is too strict, it limits the possibility of including revolving assets, future assets, and some types of proceeds as a security object.[104] The application of this principle must strike a balance between providing adequate information to identify the collateral with reasonable certainty, and not undermining the commercial utility of the security device. Brits points to the difficulty of not having a uniform standard for describing movable property, unlike the detailed system for immovable-property registration.[105] A practical solution may be able to resolve a legal issue. Prescribed methods of asset identification, similar to that used under the Cape Town Convention and Protocols, could guide domestic legal reform.[106] However, achieving the correct balance in asset identification is meaningless without an operational registration system tailored around this means of asset description.[107]

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99 S Scott 'Aard en rol van notariële verbandakte' 2005 *TSAR* 842 at 847.

100 Chapter 5 paragraphs 5.4.2.1(*e*) and 5.4.2.2 *infra* discuss the recommended standard to describe the secured obligation.

101 *Durmalingam v Bruce NO* 1964 (1) SA 807 (D) at 812H-G.

102 See the discussion on the application of specificity to special notarial bonds in paragraph 2.5.4.2 *infra*.

103 R Goode 'Asset identification under the Cape Town Convention and Protocols' (2018) 81 *Law & Contemp Probs* 135 at 136.

104 N De La Peña 'Reforming the legal framework for security interests in mobile property' (1992) 2 *Unif L Rev* 347 at 349.

105 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 265.

106 For a general discussion of the asset description methods, see R Goode 'Asset identification under the Cape Town Convention and Protocols' (2018) 81 *Law & Contemp Probs* 135 at 135-153.

107 R Goode 'Asset identification under the Cape Town Convention and Protocols' (2018) 81 *Law & Contemp Probs* 135 at 153.

In modern frameworks – eg, UCC Article 9 – 'description' of the asset contrasts with the stricter specificity principle. 'Description' means that the wording of the security agreement and the registration document must allow for reasonable identification.[108] This includes describing the asset with reference to a pre-determined category, the type of asset, quantity, and even a formula.[109] However, 'super' generic descriptions are not permitted in the security agreement, but only in the financing statement, which is the one-page registration document under UCC Article 9.[110] This resolves the potential issue of a lack of confidentiality in public notice filings. The transparency principle forms the foundation of traditional property law, along with the *numerus clausus* doctrine which is briefly discussed *infra*.

2.3.3.2 Fundamental principle: the *numerus clausus* doctrine

Even though the *numerus clausus* doctrine is more commonly linked to civil-law traditions, this does not mean that the doctrine doesn't exist in common-law traditions.[111] The goal of this doctrine is to establish an acceptable level of predictability and certainty as part of the real security law framework.[112] The *numerus clausus* doctrine implies: (1) that a closed number of real rights can be created; and (2) that the content of the absolute rights is restricted.[113] Akkermans explains the *numerus clausus* in property rights as a 'menu of property rights' from which parties must choose.[114] The practical implications are, first, that parties can only create

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108 Under the UNCITRAL instruments, as under UCC Article 9, the asset description should 'reasonably allow their identification'. See recommendations 14(*d*) and 17 of the UNCITRAL Guide.

109 HC Sigman 'Security in movables in the US-Uniform Commercial Code Article 9: a basis for comparison' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 66.

110 See HC Sigman 'Security in movables in the US-Uniform Commercial Code Article 9: a basis for comparison' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 66 and the reference to §9-504 which allows a 'super generic' asset description in the financing statement for identification purposes.

111 S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1059, 1060.

112 JM Milo 'Property and real rights' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 734. Also see PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 48.

113 JH Dalhuisen *Dalhuisen on Transnational Comparative, Commercial, Financial and Trade Law Vol 2: Contract and Movable Property Law* (5th ed 2013) at 296. See also JM Milo 'Property and real rights' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 733. See further, PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 47, 48 and S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1053.

114 B Akkermans 'The use of the functional method in European Union property law' (2013) 2 *EPLJ* 95 at 106.

those absolute rights included as part of a closed list, and second, that the content and legal nature of those absolute rights are limited to what is permitted under existing law.[115]

Even though this fundamental principle is largely responsible for the divide between the law of contract and property law in that it limits the contractual freedom of parties to a large extent, it does not completely exclude contractual freedom.[116] Usually, this principle forms part of national policy and can only be amended where a country changes its policy to allow greater party autonomy.[117] However, the doctrine does not imply that a closed list of absolute rights applies *ad infinitum*; the legislature or the courts may still introduce new rights to the list.[118] For example, South Africa does not have a closed system of real rights and it is entirely possible to create new real rights provided there is a sound reason for doing so.[119]

As with fundamental principles, ground rules form an important foundation in a property law framework and form the subject of the next paragraph.

2.3.3.3 Ground rules and technical rules

(a) Accessory relationship between the indebtedness and the security right

The core of this principle relates to whether the security right can exist whether or not there is a valid principal obligation. The general rule – which also applies in South African law – is that a security right secures the fulfilment of an obligation accessory to and secures the principal obligation or debt.[120] Accordingly, the right under the security device must relate to

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115 JM Milo 'Property and real rights' in JM Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd ed 2012) at 734. See also S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1053.

116 F Dahan 'A single framework governing secured transactions?' in F Dahan *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 69. Party autonomy is a key concept under the UNCITRAL Guide and UNCITRAL Model Law (see Chapter 3 paragraph 3.3.1(*j*) *infra*). See also S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1053.

117 B Akkermans 'The use of the functional method in European Union property law' (2013) 2 (1) *EPLJ* 95 at 118.

118 For example, retention-of-title under German law. See S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1054.

119 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 48, 49. See also CG van der Merwe 'Things' in WA Joubert & JA Faris (eds) *LAWSA* Vol 27 (2nd ed 2014) para 62. The principle usually applies in civil-law countries, for example under Belgian law. See L Ntsoane & M Wiese 'A comparative overview of the legal reform of non-possessory real security rights over movables in South Africa and Belgium with specific reference to the legal nature of the security object and court intervention' (2017) 29 *SA Merc LJ* 325 at 327.

120 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 358. In general, see the detailed analysis of the accessorial principle in N Strydom 'Die aksessoriteitsbeginsel in die Suid-Afrikaanse reg'(2000) (unpublished LLM-dissertation, Rand Afrikaans University). See also G Pienaar &

a *valid* principal obligation. Thus, the accessory relationship entails that the real security right exists to provide security for the fulfilment of an obligation.[121] Even though the accessory principle is a foundational rule of real security law frameworks, exceptions to this rule are increasingly recognised,[122] especially where it makes commercial sense to do so.

The crux of this principle was summarised in *Kilburn v Estate Kilburn.*[123] The hypothecation must be accessory to either a legal or a natural obligation. Where there is no obligation there will also be no hypothecation relating to a substantive claim in the asset.[124] The practical implication is that it would not be possible to create a real right in a future asset (an asset in which the debtor will only acquire the power to encumber the asset on a future date) or in respect of a future advance.[125] However, the South African legislature has created an exception to this general rule in the form of a covering bond.[126] A covering bond secures a debt which will only arise between the parties involved in the future.[127] Accordingly, a covering bond provides security in respect of a debt the parties intend to acquire at a future date.[128] Priority of claims under a covering bond depends on the date of registration, not on when the future debt arises.[129] As such, the priority of a right under a covering bond is an exception to the accessory principle[130] and applies strictly to a covering bond which meets specific statutory requirements. Sections 50 and 51 of the Deeds Registries Act[131] relate to future debts and allow for the creation of a covering bond.[132] In order to be valid, the covering bond must: (1) state expressly that it secures future debts in general, or a specific future debt; and (2) include the

AJM Steven 'Rights in security' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 759.

121 GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 326.

122 R Brits *Real Security Law* (2016) at 25.

123 1931 AD 501 at 506. This decision has been confirmed in subsequent cases. See *Thienhaus v Metje & Ziegler Ltd* 1965 (3) SA 25 (A) at 32F-G; *Panama Properties 103 (Pty) Ltd v Land Agricultural Development Bank of South Africa* [2005] 3 All SA 42 (SCA); and *Absa Bank Ltd v Moore* 2017 (1) SA 255 (CC) para 40.

124 R Sharrock *Business Transactions Law* (9th ed 2017) at 788.

125 A future asset is an asset that does not yet exist or one in which the debtor must still acquire a right.

126 *Panamo Prop 103 (Pty) Ltd v Land & Agricultural Development Bank of SA* 2016 (1) SA 202 (SCA) para 25. See also N Strydom 'Die aksessoriteitsbeginsel in die Suid-Afrikaanse reg' (2000) (unpublished LLM-dissertation, Rand Afrikaans University) at 58-60.

127 R Sharrock *Business Transactions Law* (9th ed 2017) at 795.

128 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 54. See also GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 396.

129 Section 87 of the Insolvency Act.

130 R Brits *Real Security Law* (2016) at 47.

131 Act 37 of 1937 (the Deeds Registries Act).

132 See mention of this exception in N Locke 'Aksessoriteit en sekerheidstelling deur middel van vorderingsregte' 2001 *TSAR* 479 at 481.

fixed maximum amount of debts that the bond secures.[133] Where the debt registered under the covering bond decreases, it will be possible to register a reduced fixed amount as an amendment to the original bond.[134]

Another practical implication of the accessorial principle relates to the event which must be used to determine the priority ranking of the limited real right. The priority can only be determined once the limited real right in the object actually exists. Again, the only exception to the general rule relates to covering bonds. In terms of section 87 of the Insolvency Act, the priority ranking depends on the date the covering bond was registered. The date when the principal obligation was created or when the debtor acquired the right in the future asset, is irrelevant in determining the priority ranking.[135]

In summary, the general rule regarding the accessorial principle is that the real security right that secures the fulfilment of the principal obligation is accessory or completely dependent on the existence of a principal obligation.[136]

An example of where the accessory principle will influence reform proposals is the issue of notice filing. It is impossible to use notice filing unless the notification relates solely to the *potential* of the accessory agreement and not necessarily the *existence* of the accessory agreement.[137] Further, as is the case with covering bonds, under notice filing the priority ranking disregards the accessorial principle, as priority ranking is determined with reference to the date of registration, regardless of when the security right came into existence.

(b) Nemo plus iuris transferre potest quam ipse habet

In terms of this rule it is not possible to transfer more rights than you actually have. This rule is 'the golden rule' of property law.[138] Consequently, to provide a limited real right in a property, the provider must either own the property or the owner must have granted a *ius*

133 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 364.
134 Section 3(1)(*g*) and (*j*) *bis* of the Deeds Registries Act.
135 The date of notice filing is also the date used to determine the priority ranking under the UNCITRAL instruments discussed in Chapter 3 paragraph 3.3.3.8 *infra*.
136 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 251.
137 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 251.
138 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 73.

disponendi to the person providing the real right.[139] Therefore, where future property is the collateral, the security right in that asset only exists when the grantor has *ius disponendi.*

Again, the implication of this rule for future reform must be considered. In the first instance, there are implications for the third-party effect of the security right where the encumbered property is transferred subject to a secured creditor's security right in the property.[140] Whether advance-notice filing (filing or registration of a security right before the rights exists) can take place, also warrants attention.[141]

(c) Prior tempore potior iure

The general priority rule is that the ranking of creditors is determined by the time of creation – first in time will be stronger in right. Essentially, the principle entails that the first party to file a notice or acquire possession of the encumbered property, will enjoy priority over the claims of subsequent creditors (the application of the anteriority principle).[142] There are, however, exceptions to this general rule which depend on specific policy considerations of the country concerned.

The impact of this rule on possible reform relates, in the main, to the exceptions created as a result of policy choices. One such exception, which does not apply under current South African law, is the super-priority afforded to an acquisition secured creditor.[143]

(d) Prohibition against a pactum commissorium

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139 JC Sonnekus 'Spesiale notariële verband, beskikkingsbevoegdheid en logiese vooroordeel' 1997 *TSAR* 154 at 154 and JC Sonnekus 'Saaklike sekerheidsreg vir onsekere toekomstige vordering en sameloop met retensiereg op roerende saak' (1999) 10 *Stell L Rev* 397 at 399. See also PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 73.

140 This can be subject to the exception of a good-faith acquirer who acquires the property in the ordinary course of the creditor's business.

141 Advanced notice filing is possible under the UNCITRAL framework which uses notice filing (see Chapter 3 paragraph 3.3.3.5(*b*) *infra*). However, advance filing is not possible under the Belgian Pledge Act of 11 July 2013 which uses transaction filing and require that the pledge agreement should be concluded before filing.

142 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 254.

143 This is a creditor who advances credit which is in turn used to acquire an asset that will serve to secure the secured transaction. The concept is discussed in greater detail in Chapter 3 paragraph 3.3.4 *infra*.

Where a debtor has defaulted, this *pactum* allows the secured creditor to claim the collateral for use or resale of the asset without first determining its fair value.[144] The principal obligation is extinguished merely by taking-over the asset, without having to pay an additional amount to the debtor. The application of this *pactum* is universally rejected,[145] including under South African law.[146] Under Roman law the *pactum* was outlawed by Emperor Constantine in 326 A.D.[147] Most legal jurisdictions have also abolished this principle.[148] The *pactum* must, however, not be confused with something akin to a *quasi*-conditional sale (where the secured creditor takes over the encumbered property against a fair value), which is a valid agreement.[149] This distinction is clarified *infra*.[150] The prohibition against a *pactum commissorium* should not be problematic in future reform; it should be retained.

(e) Prohibition against self-help in case of real security rights

To quote Professor Susan Scott on the prohibition of self-help: 'It is the cornerstone of the law in any organised society.'[151] She also remarks that the principle against self-help is as old as the law itself and existed before any modern constitution.[152] It is undisputed that self-help is unlawful in South Africa.[153]

Self-help holds a broader meaning in law. It boils down to a private individual unlawfully taking the law into her own hands.[154] However, in relation to enforcement proceedings in debt enforcement under secured transactions law, it could involve two distinct stages of

144 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 256.

145 E Dirix 'Remedies of secured creditors outside insolvency' (2008) 5 *ECFR* 223 at 231. For example, the principle is rejected under Scottish law, save in case of pawn transactions of a specified maximum amount. See G Pienaar & AJM Steven 'Rights in security' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 766.

146 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 125, 126.

147 See the brief discussion of the origin of this prohibition in B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 256-257.

148 For example, this is also the case in Scotland. See Scottish Law Commission 'Report on Moveable Transactions Volume 1: Assignation of Claims' (2017)(Scottish Law Commission Report 2017 (1)) at xxi available at https://www.scotlawcom.gov.uk/files/1715/1361/1309/Report_on_Moveable_Transactions_-_Volume_1_Report_249.pdf (date of access: 24 October 2018).

149 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 126.

150 See paragraph 2.4.5.4 *infra*.

151 S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 663.

152 S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 663.

153 This principle was clearly enunciated in *Nino Bonino v De Lange* 1906 TS 120 and confirmed in subsequent decisions, eg, *Bock v Duburoro Investments (Pty) Ltd* 2004 (2) SA 242 (SCA) para 14.

154 *Chief Lesapo v North West Agricultural Bank* 2000 (1) SA 409 (CC) para 11.

enforcement: (1) the dispossession of the collateral (potentially relying on a perfection clause);[155] and (2) the disposal of the collateral by the creditor (*parate executie*).[156] Where the secured creditor already has lawful possession of the collateral and sells the property according to the mandate of the debtor, this is potentially not self-help but *parate executie* (immediate execution).[157] Further, a perfection clause in a real agreement may provide the creditor with a right to take possession of the collateral, but typically only with court authorisation where the debtor refuses to give her possession. Where the debtor consents to the perfection of the security, the creditor can perfect her real security.[158]

One must also consider the influence of 'freedom of contract' as a counter-argument to what constitutes self-help. Where the debtor agrees contractually to certain enforcement steps, the result can hardly be regarded self-help. The creditor is merely enforcing contractual provisions in the real agreement. It is then rather a question of whether or not the provisions in the contract accord with public policy, which in turn could make the dispossession or execution under the contractual provisions unlawful. Even if the contractual provisions are not against public policy, the actions associated with enforcing the perfection clause could potentially be unlawful.[159] Consequently, nothing prevents a debtor from approaching a court on this basis.

Self-help is generally associated with repossession of the collateral without court assistance. I understand self-help to mean that a creditor takes the law into her own hands, and seizes the property *against the will* of the debtor, without allowing the debtor recourse to the courts.[160] Usually, in legal systems which allow self-help, repossession is subject to the 'without breach of peace standard'.[161] This is the standard in § 9-609 of the UCC. However, in

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155 In case of a pledge or a general notarial bond a perfection clause is used. The reference in a special notarial bond should be to a possession clause, as perfection is irrelevant.

156 In the international and regional instruments discussed in Chapters 3 and 4 *infra* there is a clear distinction between the right to take possession and the right to dispose of the encumbered asset.

157 S Scott 'A private-law dinosaur's evaluation of summary execution clauses in the light of the Constitution' (2007) 70 *THRHR* 289 at 292. See also, S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 662.

158 See S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 660. This reference mentions general notarial bonds, albeit the position includes pledges. The difference is between the time of consent, before default in case of pledges or after default in respect of notarial bonds.

159 *SA Bank of Athens Ltd v Van Zyl* 2005 (5) SA 93 (SCA) para 16.

160 *Bock* judgment at para 13.

161 AA Gikay & CG Stanescu 'The reluctance of civil law systems in adopting the UCC Article 9 without breach of peace standard-evidence from national and international legal instruments governing secured transactions' (2017) 10 *J Civ L Stud* 99 at 109.

in the American state of Lousiana,[162] which, like South Africa belongs to a mixed legal family, repossession without court intervention is strictly prohibited unless it takes place under circumstances where: (1) the debtor has either abandoned or surrendered the collateral to the secured creditor; (2) the repossession relates to a motor vehicle; or (3) where the debtor consented to repossession, either in contemplation of or after default.[163]

Under the Cape Town Convention, repossession is possible without court intervention subject to securing the *consent* of the debtor.[164] All that is required is the debtor's consent, and the Convention is not prescriptive as regards the timing of or format which this consent should take. There is no requirement that the debtor must receive a default notice. Serving a default notice on a debtor would in any event not change the self-help nature of an enforcement proceeding.[165] The instruments also do not contain a 'without breach of peace standard', which strengthens the case that enforcement under these instruments does not amount to self-help as it is not against the will of the debtor but rather an extension of a contractual provision.

The influence of the debtor's consent on the legal nature of the repossession should be analysed. The debtor's consent either qualifies as an instance where self-help is permitted (an exception to the general rule) or, if the debtor has consented, an instance where the enforcement no longer qualifies as self-help at all. This different application of the legal effect of the consent of the debtor will then be a technical rule which can differ between legal systems. The position is different where the debtor's consent to repossession has been lawfully obtained as there is no longer a legal dispute which needs to be resolved. Consequently, out-of-court enforcement of a security right does not necessarily amount to self-help where it takes place with the debtor's

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162 In general, see the discussion of self-help provisions in the State of Louisiana in AA Gikay & CG Stanescu 'The reluctance of civil law systems in adopting the UCC Article 9 without breach of peace standard-evidence from national and international legal instruments governing secured transactions' (2017) 10 *J Civ L Stud* 99 at 113-117.

163 Louisiana Revised Statutes Title 10 (Chapter 9) available at https://legis.la.gov/Legis/Law. aspx?d=74494, § 9-609(*a*). The exception relating to motor vehicles is not expressly mentioned, but it arguably falls under a provision 'expressly provided by law' (§ 9-609(*a*)(4)) where this exception was introduced under a different piece of legislation. See this deduction by AA Gikay & CG Stanescu 'The reluctance of civil law systems in adopting the UCC Article 9 without breach of peace standard-evidence from national and international legal instruments governing secured transactions' (2017) 10 *J Civ L Stud* 99 at 116.

164 Article 8(1)(*a*) of the Cape Town Convention. South Africa has filed a declaration in terms of art 54(2) and arguably the premise is that the creditor's remedy 'may be exercised without court action and without leave of the court' according to the UNIDROIT website. See https://www.unidroit.org/franchise-2nd-other-lang/141-instruments/security-interests/cape-town-convention-mobile-equipment-2001/depositary/declarations-by-article/446-article-54-2-declarations-deposited-under-the-cape-town-convention-on-international-interests-in-mobile-equipment (date of access: 26 February 2019).

165 AA Gikay & CG Stanescu 'The reluctance of civil law systems in adopting the UCC Article 9 without breach of peace standard-evidence from national and international legal instruments governing secured transactions' (2017) 10 *J Civ L Stud* 99 at 125, where the authors argue that this is the true of the Romanian framework.

lawful consent. After all, the prohibition against self-help applies only where the debtor is 'despoiled of his/her property against his/her will' without a court order.[166]

The prohibition on self-help is included under section 34 of the Constitution of the Republic of South Africa, 1996, as follows:

> 'Everyone has the right to have any *dispute* that can be resolved by the application of law decided in a fair public hearing before a court or, where appropriate, another independent and impartial tribunal or forum' (emphasis supplied).

Section 34 applies when there is *a dispute of law* which needs to be resolved. It does not limit the resolution to court action alone, but includes action by an 'independent and impartial' tribunal or forum. It, therefore, allows for adjudication outside of the courts – eg, using alternative dispute resolution mechanisms.

The extrajudicial enforcement measures which form part of the international framework (discussed in Chapter 3) and the regional framework (discussed in Chapter 4) are divided into two separate actions: (1) extrajudicial repossession of an encumbered asset; and (2) the extrajudicial disposition of an encumbered asset. In respect of the first action, as registration is the primary publicity method, the contractual clause allowing the possession is only a perfection clause where publicity takes place through possession. Accordingly, a contractual clause allows dispossession, without court intervention, subject to compliance with specific requirements, most importantly, that the debtor consents to the repossession.[167] As regards the second action, advance notice of the extrajudicial disposition must be given to the debtor and other interested parties. However, arguably, the disposition takes place without further consent, meaning no consent beyond the consent to repossession is required.

The argument in favour of self-help is that it provides the creditor with a quick enforcement remedy before the collateral ends up in the hands of a third party. The creditor

166 S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 663.

167 Excluding the enforcement measures under the EBRD Model Law on Secured Transactions, where the debtor does not have to consent to the repossession (see Chapter 4 paragraph 4.2.3.2(*h*) *infra*). As regards the UNCITRAL framework, see Chapter 3 paragraph 3.3.3.10(*b*) *infra* and for the Model Inter-American Law on Secured Transactions, see Chapter 4 paragraph 4.3.3.6 *infra*.

may have difficulty following the collateral into the hands of a third party, which links with the next ground rule.

(f) Mobilia non habent sequelam ex causa hypothecae

Roman law acknowledged the right of tracing.[168] This maxim applies to movable things that have been pledged or mortgaged, ie alienated to a third party.[169] Where the pledgee has parted with the object voluntarily, the pledgee and the holder of a general notarial bond cannot follow the movable property into the hands of a third party.[170] The policy consideration behind this doctrine is to protect subsequent *bona fide* purchasers, but also to ensure that commerce flows freely.[171] The protection of *bona fide* purchasers also takes place through the ordinary-course-of-business and good-faith exceptions found in the legal instruments discussed in Chapters 3 and 4. However, under these instruments in those chapters, the exceptions apply to non-possessory security devices, whereas the maxim under discussion was developed within the context of possessory security devices.

The *mobilia* maxim implied that the security right only existed as long as the secured creditor retained possession. Despite earlier authority, it is generally accepted that this maxim, does not apply to non-possessory security rights.[172] Technically, the maxim cannot apply in the case of special notarial bonds as there is no true possession, only deemed possession.[173] Consequently, under the SMPA the doctrine does not apply to special notarial bonds. The policy considerations behind this exclusion are in all likelihood the expectation that third parties will consult the public register before purchasing movable property (constructive notice),[174] and that they are unlikely to use an instrument where their hard-come-by security

168 P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 622. Tracing not only involves following the object into the hands of a third party, but also following the proceeds of the object or a new object formed (at 623).

169 CG van der Merwe 'Things' in WA Joubert & JA Faris (eds) *LAWSA* Vol 27 (2nd ed 2014) para 54.

170 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 258 and the sources listed at n 54.

171 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 258.

172 WJ Zwalve 'A labyrinth of creditors: a short introduction to the history of security interests in goods' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 45.

173 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 258, 259.

174 This reason is suggested by R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 259. However, constructive notice is not recognised in the case of notarial bonds and knowledge by a third party cannot be assumed.

could easily be lost by the application of the *mobilia non habent sequelam* maxim.[175] The current registration system is not perfect. It appears contradictory that a *bona fide* purchaser is protected where a possessory pledge is involved, but not in the case of special notarial bonds. Sacks identifies the application of this maxim as an area in need of reform.[176] The only way the maxim's role can be reduced is by introducing an effective method of publicity. Undeniably, the 'useless systems of registration and notification' results in the law being left to protect both purchasers and pledgees (or mortgagees) against the debtor disposing of the encumbered property.[177]

Interestingly, however, where the SMPA protects the secured creditor by not extending the *mobilia* rule to special notarial bonds (a non-possessory security), other reform initiatives are developing in the opposite direction, where the ordinary-course-of-business and good-faith exceptions also protect specific purchasers in case of non-possessory security. These exceptions are used to improve trust in commerce. Most of the instruments discussed in the chapters *infra* extend protection to purchasers where the encumbered goods have been sold in the ordinary-course-of business.

(g) The abstract or causal theory of transfer of real rights

The transparency requirements and the transfer system of rights are interrelated. For this reason, the theory of the transfer of real rights is better classified as a technical rule applied as part of the transparency requirements. Under the causal theory, if the transfer of the real right is to be valid, there must be a valid underlying loan agreement which gives rise to a lawful *causa*.[178] Conversely, under the abstract theory, all that is required is a valid real agreement to enable the transfer of the real right; the transfer of ownership is regarded as a separate act.[179] The difference between the theories has practical relevance, especially for the *bona fide* acquirer. In the case of a causal system, where the founding contract is invalid a successor in title cannot obtain any title, and the transferor may reclaim the object from that successor.[180]

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175 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 259.

176 P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 631.

177 P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 631.

178 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 74. See also, S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1061.

179 S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1061.

180 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 75.

However, the abstract system protects the *bona fide* acquirer, and the transferor cannot reclaim the object from her.[181] South African law follows the abstract theory for the transfer of real rights.[182]

Practical examples of how this ground rule may influence important aspects of modern secured transactions law include whether there must be a clear separation between creation and third-party effectiveness, and the legal effect of notice filing. In the case of notice filing under modern secured transactions law frameworks, the information in the register is not regarded as 'verified and guaranteed'.[183] The purpose is more to provide public notice of the information that an inquiring party can then use to conduct proper due diligence. Therefore, where this form of publicity is applied, one must determine which theory – abstract or causal – is more appropriate.

The fundamental principles discussed above form the foundation for the South African real security law framework. What follows is a discussion of two categories of real security, common-law pledges and notarial bonds. This is followed by a discussion of *quasi*-security – ie, title-based security devices. *Quasi*-security rights are included even though they do not qualify as real security *per se*, as they serve the same economic function as real security; they facilitate secured financing.

2.4 Possessory pledges

2.4.1 Introduction and overview

This paragraph will focus, in the main, on the legal nature of common-law pledges. It should be noted, however, that 'pledge' is also included in the definition of a secured loan in the NCA. Further, as a pawn transaction under the NCA also involves the transfer of 'possession of goods

181 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 75.

182 See PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 75 and the discussion of *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 1941 AD 369, where the Appellate Division (as it then was) confirmed an abstract system of transfer. See also, N Strydom 'Die aksessoriteitsbeginsel in die Suid-Afrikaanse reg' (2000) (unpublished LLM-dissertation, Rand Afrikaans University) at 53.

183 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 232.

as security',[184] it links to a traditional pledge, but is subject to additional provisions under the NCA.[185] Accordingly, 'pledges' under the NCA are discussed briefly.[186]

The first part of this paragraph provides a broader context to the operation of pledges. The discussion includes an introduction to the historical context surrounding the relevance of using a possessory pledge and an evaluation of whether its application is sufficiently comprehensive to justify a place for pledges in the commerce of today. Further, the creation of a pledge, which coincides with third-party effect, is examined.

The second part of this paragraph relates to the operation of pledges, with specific reference to the elements of the legal framework applicable to pledges.[187] The paragraphs dealing with the operation of possessory pledges conclude by commenting on the efficacy of the enforcement proceedings applicable to pledges.

As proposed by the Scottish Law Commission on possible law reform of Scottish law relating to security rights in movable property,[188] the initial proposal in this study is that possessory pledges be retained as part of the South African framework. However, possessory pledges should only be used in conjunction with an effective non-possessory security device.

A possessory pledge is the 'primary and traditional form' of real security over movable property.[189] A pledge 'is an ancient security' known in almost every legal system,[190] and continues to exist in some form in modern legal systems alongside non-possessory security devices.[191]

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184 Section 1 of the NCA. See also, the general discussion in R Brits 'Pledge of movables under the National Credit Act: secured loans, pawn transactions and summary execution' (2013) 25 *SA Merc LJ* 555 at 561-565.

185 For example, a pawn transaction must be below R8 000; the period is a maximum of six months; and the maximum interest which can be charged is 5%. A pawn transaction outside these parameters will fall outside the NCA.

186 As consumer law is generally excluded from secured transactions law, this study will not include a detailed discussion of the South African consumer credit law in the NCA.

187 This links back to the research questions posed in Chapter 1 paragraph 1.4 *supra*.

188 Some reforms were suggested in respect of the law of possessory pledge. Nevertheless, codification of the law of pledge was postponed. See the Scottish Law Commission 'Report on Moveable Transactions: Volume 2: Security over Moveable Property' December 2017 (Scottish Law Commission 2017 (2) report) para 16.31 available at https://www.scotlawcom.gov.uk/files/9215/1361/1360/Report_on_Moveable_Transactions_-_Volume_2_Report_249.pdf (date of access: 5 March 2018).

189 Possessory pledges were the primary security device, used especially in civil law countries. See U Drobnig 'Secured credit in international insolvency proceedings' (1998) 33 *Tex Int'l LJ* 53 at 55; R Brits *Real Security Law* (2016) at 106; and PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 391.

190 Scottish Law Commission 2017 (2) report para 17 at 10.

191 All the legal instruments discussed in Chapters 3 and 4 *infra* include possessory security devices. Even though the EBRD Model Law refers to a possessory charge, subsequent references are to 'pledge'.

The elements of the typical definition of a pledge are that it is a limited real right in a movable thing, created by the delivery of the pledged thing to the pledgee (transfer of possession)[192] securing the fulfilment of an obligation (both a money and a natural obligation) the pledgor[193] or a third party owes to the pledgee.[194] The limited real right comes into existence only once possession of the pledged object has been transferred to the pledgee (secured creditor) who must obtain physical control over the movable property. The pledge continues for as long as the creditor maintains control over the pledged object.[195] Until delivery has taken place, the pledgee has a personal right against the debtor for the fulfilment of the principal debt.

As indicated above, a potential reason for secured transactions law reform is to find a non-possessory security device which can serve as an alternative to the traditional pledge construct. Accordingly, understanding the basic legal structure of a traditional possessory pledge remains relevant in order: (1) to develop a non-possessory pledge which can bypass the limitations of a traditional pledge in a legally efficient manner; (2) to be able to adapt the pledge provisions to allow for the introduction of 'warehousing' (where a third-party exercises control over the pledged object on behalf of the creditor); (3) to be able to adapt the pledge rules to accommodate incorporeal movable property under the same (or similar) rules;[196] and (4) to use the law applicable to traditional pledges as the foundation for the interpreting law applicable to other types of security which form part of the South African framework – eg, general notarial bonds.

The legal nature of the traditional pledge is canvassed *infra* in greater detail with the focus on how the fundamental principles of this form of real security compare with the fundamental principles under the legal instruments discussed in Chapters 3 and 4. Nevertheless, it would be remiss to ignore the legal concept of cession *in securitatem debiti* (which involves security by means of claims), where the concept of a claim to the book debts of the debtor (receivables) fulfils an important security role in most secured transactions law frameworks. Cession *in securitatem debiti* is an attempt to merge those principles associated with pledges

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192 The pledgee will be the entity that advanced funds and requires the pledged object as security for fulfilment of the contractual obligations.

193 A pledgor is the person who either owns the pledged object, or has the *ius disponendi* to grant a pledge over the object on behalf of another.

194 See the definition in R Brits *Real Security Law* (2016) at 107 and the sources for the definition of a pledge noted in n 3. See also TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 2.

195 R Brits *Real Security Law* (2016) at 106 and R Sharrock *Business Transactions Law* (9th ed 2017) at 796.

196 R Brits *Real Security Law* (2016) at 108. Technically incorporeals are pledged using cession *securitatem debiti.* A brief discussion on cession is included at 2.4.6 *infra*.

(law of property) with the law of contract (law of obligations).[197] Accordingly, the law which applies to cession is grounded both in property law and the law of contract.[198] The discussion of cession will be brief in that the complexity of theoretical debate on the legal nature of cession potentially undermines the focus of this study on corporeal movable assets. The final paragraph under the pledge discussion is devoted to cession.[199]

2.4.2 Comprehensive scope: assets, obligations, transactions and parties

2.4.2.1 Asset

Any movable property with commercial value can be pledged. Why a pledge applies only to movable property is that it must be possible for the pledgee to exercise physical control over the pledged object.[200] It is theoretically correct that both corporeal *and* incorporeal movable property can be pledged, but technically, incorporeal movable property is pledged through cession *in securitatem debiti*.[201]

As regards corporeal movable property a pledge can be taken over both a single asset (*res singularis*) and a universal thing – either a composite thing or a collection of movable things constituting an economic entity, such as a flock of sheep, a fleet of motor vehicles, or stock-in-trade.[202] Although this resolves the problem of replacing single assets when they form part of the economic entity during the course of a pledge,[203] as the right of pledge is indivisible a creditor will have to take possession of the entire economic entity to establish a limited real right in the assets.[204] However, until the point of perfection it is possible to replace a single asset which forms part of the economic entity in that the pledged object is the economic entity

197 R Brits *Real Security Law* (2016) at 273.
198 R Brits *Real Security Law* (2016) at 273.
199 See paragraph 2.4.6 *infra*.
200 R Brits *Real Security Law* (2016) at 111.
201 R Brits 'Pledge of movables under the National Credit Act: secured loans, pawn transactions and summary execution clauses' (2013) 25 *SA Merc LJ* 555 at 557.
202 See R Brits *Real Security Law* (2016) and the authors quoted at 111 n 24 and GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 413. Some other jurisdictions only adopted a pledge of an 'economic unit' much later (eg, the Polish Law on Registered Pledges of 1996, art 7, where use of 'economic entity' was preferred above adopting a unitary concept of security interest).
203 In *Burger v Rautenbach* 1980 (4) SA 650 (C) at 652H-653A the court held that where a flock of sheep is pledged *universitas rerum*, if an individual sheep is replaced after the pledge agreement has been concluded, as the economic entity (the flock of sheep) is subject to the pledge, it is possible to replace parts of the economic entity, leaving the pledge intact. However, it is assumed that this can only take place until perfection.
204 GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 406 and the sources listed at n 12.

as a whole at the time of perfection. Consequently, paying-down the debt does not reduce the extent to which the collateral is burdened.[205]

It is not commercially feasible to take a *possessory* pledge over revolving property, for example, a stock-in-trade. The debtor must be able to sell the inventory in the ordinary course of business, which is problematic where the creditor has control over the pledged object. In all likelihood, the secured creditor would elect not to take possession of the stock and rely on her personal right against the debtor backed by the strength of the debtor's creditworthiness. The creditor can also appoint a third party to take control of the pledged object on her behalf and release the pledged object to a buyer, either partially in case of a pledge of an economic entity, or as a whole when the debt has been paid.

It is also conceivable to pledge a future thing (*res futurae*) but the limited real right will exist only from the moment the future asset actually comes into existence and is delivered to the creditor.[206] Thus, it is more correct to say that an undertaking to constitute a pledge may be provided, but the right to pledge can only exist in an asset that exists and which the debtor has the right to pledge.[207]

It is also theoretically possible to take a pledge over an entire business, even though the practical process remains debatable. There are questions as to practical considerations of what actually constitutes 'the entire business' and how possession or control is delivered to the pledgee. The creditor has no more than a personal right against the debtor until she has taken possession of the movable property – in this instance, the entire business. In this light, it is clear that commercial reality requires a non-possessory pledge over the debtor's entire business.[208]

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205 GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 406 and the comment at n 12.

206 See R Brits *Real Security Law* (2016) and the authors quoted at 112 n 29.

207 GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 412.

208 The EBRD Model Law, uses an enterprise charge (see Chapter 4 paragraph 4.2.3.2 *infra*). See also the '*pand op handelzaak*', recognised under Belgian law before the recent amendment. This non-possessory pledge existed over a business, before the amendment of the Belgium Civil Code 1804 (*Burgerlijk Wetboek*) arts 2071-2091) by the Belgian Pledge Act of 11 July 2013, where specific reference to the business pledge and the agricultural pledge were removed. Before the amendment, the business pledge included all the elements of goodwill, but excluded 50% of the inventory. Also, only banks and other financial institutions could acquire this pledge. These restrictions no longer apply and the general pledge in terms of the new Act is now broader but continues to allow that a pledge in respect of the business may be taken, albeit no longer under a separate name. See E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 233 (for the previous position) and 242 (for the new position).

A pledge also extends to the fruits, hanging and separated, of an object, as well as any additions or accessions to the pledged object.[209] It is even possible for the pledgee to *consume* the fruits, subject to an equivalent reduction the interest and principal debt in terms of a *pactum antichreseos.*[210] Further, in accordance with the principles of *accessio*, where the pledged object is attached to immovable property the pledge potentially no longer exists as the pledged object is no longer regarded as movable property – it will have been 're-characterised' as immovable property. In this regard, whether re-characterisation takes place depends on factors which may include: the nature of the pledged object; the degree and manner of attachment; and the intention of the owner of the pledged object.[211]

A pledge continues to exist while the pledged object exists independently as a movable object. Only where the *pledgor* is responsible for converting the pledged object into a completely new product, will the pledge continue to exist in the manufactured product.[212] Where the pledged object is attached to immovable property and its separate identity is lost, the previously movable property is now characterised as immovable property, and the pledge ceases to exist as possession will have been lost.[213] As regards a pledge over a *res singularis*, the pledged object cannot be substituted. This means that the pledged object cannot be replaced by money realised from its sale[214] – the pledge does not extend to the proceeds from the sale of the pledged object.

2.4.2.2 Obligations and parties to the pledge transaction

A pledge can secure any type of lawful contractual obligation[215] including a future debt, but its priority ranking depends on the date of delivery.[216] The pledge exists as soon as it is possible to take possession of the future object and it is doctrinally correct to say that the pledge

209 R Brits *Real Security Law* (2016) at 112. In respect of *accessio*, see also TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 132.

210 R Brits *Real Security Law* (2016) at 108. Also referred to as '*pandgenot*' under Roman-Dutch law. See TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 121).

211 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 133, specifically the sources listed at n 51. The extension of the real right to proceeds, fixtures, and a mass or product, is discussed further in paragraph 2.5.4.4 *infra*.

212 R Brits *Real Security Law* (2016) at 114.

213 R Brits *Real Security Law* (2016) at 114.

214 *Lesedi Secondary Agricultural Co-operative Ltd v Vaalharts Agricultural Co-operative* 1993 (1) SA 695 (NC) 699C-H following *Krapohl v Oranje Koöperasie Bpk* 1990 (3) SA 848 (A) at 865B-D and at 865J-866A.

215 R Brits *Real Security Law* (2016) at 114.

216 Even though it could be argued that an asset that does not yet exist, must be handed over to constitute the pledge, the pledge agreement in respect of a future property may be entered into and the pledge is constituted as soon as the future property comes into existence and is subsequently delivered to the pledgee.

agreement in respect of future debt is rather an *undertaking* to pledge. The pledge terminates either when the pledgee loses possession, or once the debtor no longer has a personal obligation towards the creditor.

It is also possible to pledge an object owned by a third party, subject to the permission of the owner or her subsequent ratification of the pledge obligation where the pledge agreement allows ratification.[217] Where the third party is not a party to the principal loan agreement, the accessory principle requires a relation between the third party's limited real right and the debtor's principal obligation. To establish a sufficient legal link between the pledge and the principal obligation the third party must bind herself as surety and co-debtor.

That a pledge is indivisible raises practical problems. A pledge hypothecates the entire pledged object.[218] Consequently, even if the debtor pays-down the debt, arguably where the pledged object is an economic entity, the burden on the entire economic entity continues until the debt has been paid off. It is not possible to release specific elements of the economic entity from the scope of the pledge.

The general rule is that any natural person or corporate entity may be a party to a pledge agreement subject to her having the necessary contractual capacity to enter into the agreement.[219] However, pledges recognised under the NCA require a *registered* credit provider to conclude a credit agreement with a consumer if the transaction falls within the scope of the Act.[220]

2.4.3 Creation and third-party effectiveness of the pledge occur simultaneously

The creation and enforceability of the pledge against all third parties (*erga omnes* enforceability) occur simultaneously. Until the pledged object has been delivered to the pledgee (by means of a form of delivery recognised to constitute a pledge), the creditor has only a personal right against the debtor to perform a contractual obligation. However, the requirement that the debtor must be dispossessed to constitute a pledge, limits the application of a pledge in modern commercial reality. Dispossession is archaic and commercially impractical as the

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217 JC Sonnekus 'Met andermanskalf mag jy nie ploeg nie, en andermandgoed kan jy nie verpand nie' 2014 *TSAR* 45 at 47.

218 R Brits *Real Security Law* (2016) at 112.

219 Nevertheless, where special types of pledge are created – eg, a business pledge – it could be considered to limit the categories of permissible pledgees.

220 Section 40 of the NCA. A credit provider needs to register with the National Credit Regulator before it can operate as a credit provider under the NCA.

debtor needs the pledged property to generate income with which to service the debt owed to the creditor.[221]

There must be a valid loan agreement (creating a principal obligation) before a pledge can be created. The limited real right is constituted when there is: (1) a valid pledge agreement (reflecting the intention that the pledged object is to be held as security) which is the real agreement;[222] and (2) the constitutive action has taken place. The constitutive action entails transferring possession of the pledged object to the pledgee (or the creditor) who then exercises physical control over the pledged object.[223] The discussion *infra* clarifies that only specific forms of delivery of the pledged object can constitute a pledge.

2.4.3.1 Transfer of possession: recognised forms of delivery

(a) General requirements

For purposes of creating a pledge, possession consists of two elements. First, there must be a shared intention that the creditor will hold the debtor's movable property as security (the *animus* or the mental or subjective element).[224] The second element includes the *physical* expression of this shared intention, thus the objective element.[225] This happens when the pledgee obtains and retains the capacity to exercise physical control, in the broader legal sense, over the pledged object. This is referred to as *detentio.*[226] Consequently, to constitute a pledge 'delivery' requires both a physical and a mental element.

The legal control over the pledged object shifts from the pledgor to the pledgee on delivery – within the meaning assigned *supra* – of the pledged object.[227] At this moment the

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221 It is clear that delivery as a method by which to perfect the right of the pledgee does not meet the needs of modern credit practice. See in this regard, JC Sonnekus 'Sekerheidsregte-'n nuwe rigting?' 1985 *TSAR* 97 at 108 and TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 57.

222 The pledge agreement has no specific formalities (it need not be in writing), but must at least reflect the shared intention that the movable thing is to be held as security for the performance of a principal obligation until the principal debt has been discharged. See R Brits *Real Security Law* (2016) at 117 and TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 58.

223 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property (*5th ed 2006) at 390-391. See also TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 57.

224 Legal possession involves that the person exercise control over the hypothecated property with the aim of the preservation of the right of the creditor over the movable property. See TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 60.

225 CG van der Merwe 'Things' in WA Joubert & JA Faris (eds) *LAWSA* Vol 27 (2nd ed 2014) paras 74, 75.

226 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 57.

227 Legal control does not necessarily entail actual physical control by the pledgee, but rather limits parties other than the pledgee from exercising control over the object. See R Brits *Real Security Law* (2016) at 122.

limited real right comes into existence and has third-party effect as soon as the pledged movable property has been: (1) delivered to the pledgee (or her agent); and (2) the pledgee can exercise *continuous* control over the pledged object.[228] 'Continuous' means that the pledgee does not voluntarily part with the object. Typically, where the pledgee hands the pledged object back to the pledgor, the pledgor will no longer have been divested of all control over the pledged object and the pledge will no longer exist. However, the courts have recognised instances where the return of the pledged property to the pledgor does not extinguish the pledge. These include: (1) where the pledge is taken from the pledgee against her will;[229] (2) where the pledged object was handed to the pledgor to sell on behalf of the pledgee in order to secure a higher selling price;[230] and (3) where the pledgee gives the pledged object to the pledgor to repair.

Not all methods of delivery constitute a pledge and we turn now the distinction between delivery methods that constitute a pledge and those which do not.

(b) Recognised methods of acquisition of possession to constitute a pledge

To constitute the limited real right under a pledge, transfer of possession must be either: (1) actual or real delivery (*traditio vera*); or (2) some forms of constructive delivery discussed *infra*. Real or actual delivery is straightforward as physical control presupposes legal control.[231]

Constructive delivery means that even though the pledged object does not move physically, physical control is deemed to have been transferred to another.[232] Certain types of constructive delivery also constitute a pledge under South African law. These include: (1) delivery with the short hand; (2) attornment; (3) symbolic delivery; and (4) fixing of a mark to the pledged object. In delivery with the *short hand* the person to whom the object should be transferred is already in possession of the pledged object. Delivery takes place when the parties agree that the current holder now holds the object as a pledgee.[233] The delivery is based on a changed intention coupled with an agreement between the parties which reflects this change.[234]

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228 *Zandberg* judgment at 313. Further, see PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property (*5th ed 2006) at 392. The continuous control ensures compliance with publicity of the existence of the limited real right. See JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 118.

229 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 62, specifically the different lines of reasoning in this regard mentioned in n 167.

230 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 62.

231 R Brits *Real Security Law* (2016) at 123.

232 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 63.

233 *Meintjies v Wilson* 1927 OPD 183 and the *Vasco Dry Cleaners* judgment at 611H.

234 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 64.

Delivery through *attornment* provides the constitutive element for a pledge.[235] Attornment constitutes a pledge where a third party who previously controlled the pledged object on behalf of the pledgor, exercises legal control on behalf of the pledgee subsequent to the pledge agreement.[236] The legal control is established through a mandate agreement concluded between the third party (the custodian), the pledgee, and the pledgor. Put simply, the mandate agreement provides the third party with a new mandate to exercise control over the pledged object on behalf of the pledgee. Even though physical control remains with the custodian, legal control changes from the owner (debtor or pledgor) to the pledgor (creditor) as a result of the application of the mandate agreement.[237] Arguably, even where the custodian does not have possession when the mandate agreement is entered into, the custodian can declare a willingness to hold the property on behalf of the creditor from a future date.[238] A commercially relevant example is where a custodian holds the pledged object on behalf of the creditor or pledgee (warehousing takes place). *Symbolic delivery* is another form of constructive delivery which constitutes a pledge. Symbolic delivery uses a symbolic instrument to allow the pledgee or its agent to exercise *exclusive* and *effective* control over a pledged object.[239] If indirect control is used, the pledgee must divest the pledgor of *all* control.[240] A commercially relevant example is where possession of goods is transferred by handing over the bills of lading in respect of shipped goods.[241]

In theory, delivery with the long hand (*traditio longa manu*) could be used to constitute a pledge.[242] *Traditio longa manu* applies where the mere size or weight of the pledged object

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235 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 64, 65. See also R Brits *Real Security Law* (2016) at 128.

236 See *Air-Kel* judgment at 924 where it was confirmed that the third party can start holding the object on behalf of the owner, but then agree to hold it on behalf of the pledgee at a specific future time.

237 R Brits *Real Security Law* (2016) at 129.

238 See R Brits *Real Security Law* (2016) at 130,131 and the author's reference to the *Air-Kel* judgment and *Caledon & Suid-Westelike Distrikte Eksekuteurskamer Bpk v Wentzel* 1972 (1) SA 270 (A). See also TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 64, 65.

239 *S v Buitendag* 1980 (2) SA 152 (T) at 154D (the *Buitendag* judgment).

240 R Brits *Real Security Law* (2016) at 124. An example of indirect control is where all the keys or access codes to a warehouse in which the pledged object is stored, are handed over to the pledgee or its agent.

241 See TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 65 and the case law at n 184. See also DL Carey Miller & A Pope 'Acquisition of ownership' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 698.

242 R Brits *Real Security Law* (2016) at 136 and the sources at n 147. See also TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 65. The authors both refer to *Matabeleland Trading Association Ltd v Bikkers* 1927 SR 78 as authority that this delivery method may constitute a pledge. See also the *Buitendag* judgment at 154H confirming that *traditio longa manu* is permitted as a delivery method capable to constitute a pledge (even though the court held the elements for this type of delivery were not apparent in this matter).

makes actual delivery impractical.[243] The delivery occurs where the transferor makes it possible for the transferee to see the object and says something like 'this is the asset I want to transfer, or pledge, to you', [244] while also ensuring that only the pledgee can exercise control over the pledged object.[245] Consequently, it is not only about placing the pledged object 'in sight', but the pledgee must also be able to *exercise control* over the object.[246] This means that the pledgee must be able to 'immediately exercise effective control' over the corporeal movable property.[247]

Yet another form of constructive delivery not often mentioned, is delivery by fixing a mark to the movable property.[248] This form of delivery could, in theory, also apply to non-possessory pledges. The purpose of the mark is to inform third parties that the movables are hypothecated. However, there are practical problems and uncertainty associated with using a mark as a delivery method which render its use for purposes of pledge very tenuous. These issues include that: (1) the mark only indicates that the property is hypothecated and does not specify for what amount or in whose favour it is encumbered; (2) the nature and meaning of a mark is insufficiently universal to provide effective publicity to those seeing it; and (3) it might be possible to remove or tamper with the mark which compromises its value as real security.

(c) Constitutum possessorium *not constituting a pledge*

In contrast to the above forms of delivery that can be used to establish a pledge, *constitutum possessorium* cannot constitute a pledge. In the case of *constitutum possessorium* the ostensible pledgor remains in control of the object as the pledgee's agent.[249] While *constitutum possessorium* may have the same economic (or functional) effect as actual delivery, it has no

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243 R Brits *Real Security Law* (2016) at 136; TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 65; PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 182.

244 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 65.

245 R Sharrock *Business Law Transactions* (9th ed 2017) at 922.

246 *Groenewald v Van der Merwe* 1917 AD 233 at 239. This case held that the principle in respect of control in the transfer of ownership applies equally to pledges.

247 *Buitendag* judgment at 154F.

248 See JC Sonnekus '*Constitutum possessorium* en die oordrag van saaklike regte (slot)' 1979 *TSAR* 119 at 134-135 and R Brits *Real Security Law* (2016) at 138 where it is stated that using a mark as a method of publicity would be more suitable where there is an established method in a specific industry (eg, example cattle branding).

249 *Goldlinger's Trustee v Whitelaw & Son* 1917 AD 66 (the *Goldlinger's Trustee* judgment) at 79 confirming the decision in *Lighter v Co v Edwards* 1907 TPD 442 (the *Lighter* judgment). Further, some authors disagree that extending the application of the *constitutum possessorium* is the answer, and that a new type of non-possessory pledge with proper publicity should rather be created. See JC Sonnekus '*Constitutum possessorium* en die oordrag van saaklike regte (slot)' 1979 *TSAR* 119 at 139.

application under pledge.[250] There are two main objections to recognising *constitutum possessorium* as a delivery method. First, it may create a false impression of the pledgor's financial position as the pledgor retains control over the pledged object.[251] Traditionally, parties have used *constitutum possessorium* 'to cloak the true nature of a transaction'.[252] Such instances would fall foul of the Roman-Dutch rule that for the pledge to be effective the *pledgee* must obtain possession of the pledged object.[253] Effectively, control should be transferred to the creditor, and the debtor is required to be completely divested of control over the pledged object. This does not happen under *constitutum possessorium*.

The courts could be open to this delivery method under *exceptional* circumstances where: (1) there are necessary safeguards in place to protect the interest of all the parties involved;[254] (2) where it is clear there was 'absolute *bona fides*';[255] and (3) were no other creditors are affected by the transaction.[256] In the final analysis, using *constitutum possessorium* as a delivery method should ideally only be available where a legal framework does not allow the registration of a non-possessory security device.

In *Stratford's Trustees v The London & SA Bank*[257] the court held that 'exigencies of commercial transactions' could result in circumstances where the actual transfer of possession will not be required to constitute a pledge (effectively accepting *constitutum possessorium* as a delivery method for pledges). However, the possession must be deemed compatible with 'good faith, and it should not hold out false colours to creditors'.[258] This case did not, however, create a general rule accepting *constitutum possessorium* as a delivery method for pledges. It was an *ad hoc* application based on a specific set of facts. In this instance, the creditor returned possession of a pledged object – wool – solely for the debtor to clean the wool (not for the debtor's use) and return it to the creditor (thus in terms of a contract of *locatio operis faciendi*).

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250 Maasdorp JA in *Goldlinger's Trustee* judgment at 89, makes it clear that *constitutum possessorium* 'is of no avail in the case of a pledge of movables'. See also TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 65 where they state that this form of delivery cannot apply under pledge. Also, the Scottish Law Commission 2017 (2) para 25.7 ecommended that the prohibition against using *constitutum possessorium* remain.

251 *Ikea Trading UND Design AG v BOE Bank Ltd* 2005 (2) SA 7 (SCA) para 22 (the *Ikea Trading* judgment).

252 *Goldlinger's Trustee* judgment at 74.

253 *Lighter* judgment at 445.

254 The only real safeguard would be if third parties and creditors receive proper notice of the true nature of the transaction. Accordingly, prior notice potentially introduces a non-possessory security device.

255 The *bona fides* should be understood to relate to establishing the true intention of the parties when they entered into the agreement. See JC Sonnekus '*Constitutum possessorium* en die oordrag van saaklike regte (slot)' 1979 *TSAR* 119 at 125 interpreting the *Goldlinger's Trustee* judgment.

256 This was said in relation transfer of ownership through *constitutum possessorium* by Maasdorp CJ in *Woodhouse v Odendaal* 1914 AD 66 at 74.

257 (1884) 3 EDC 439 (the *Stratford's Trustees* judgment).

258 *Stratford's Trustees* judgment at 453.

The important consideration was that the pledged object was not returned for the use and enjoyment of the debtor, but for a different, contractually agreed, purpose (cleaning). Accordingly, the pledge, in this instance remained valid.

Without belabouring the point any further, the scope for the use of *constitutum possessorium* as a form of delivery is so limited and uncertain that it cannot be regarded as a realistic model for effectively creating a type of non-possessory security right in movable property.

(d) Suitability of dispossession in a modern security regime

Historically, it made sense to dispossess the pledgor to perfect a pledge. In the first instance, it remains easier for the creditor to protect and enforce the pledge if the object is in its possession. Further, possession fulfilled the publicity function, where a false sense of the debtor's creditworthiness was avoided if the creditor had possession. But dispossession no longer makes commercial sense. The debtor needs possession of the pledged object either to generate income to service the debt, or to sell the object and settle the debt from the proceeds. Accordingly, especially where the pledged object is revolving – eg, stock-in-trade – using a possessory pledge is impractical.

Possession of the pledged object results in additional risks and effort for the creditor who would have to take reasonable care of the pledged object in its possession. The creditor's true purpose is to hold the property as security for the indebtedness, not to own or become the owner of the pledged object. Taking care of another's property is not an attractive or commercially realistic option for any creditor. Moreover, where an entire business is pledged, dispossessing a business from the key individuals experienced in running it could result in the failure of the business and complicate its sale as a going concern.

This notwithstanding, possession as a means of publicity still has a place in modern secured transactions law, but only as a secondary method of publicity and only where publicity through registration is not feasible due to the specific nature of the pledged asset (eg, negotiable instruments). The need to retain possession as a publicity method is also reflected in the international and regional instruments discussed in Chapters 3 and 4.[259]

[259] Chapter 3 paragraph 3.3.3.5(*c*) *infra* and Chapter 4 paragraph 4.3.3.4 *infra*.

2.4.4 Priority depends on the date of perfection

In case of a possessory pledge, there is no question of priority until the pledged object has been delivered to the pledgee. The creditor's priority is lost when the pledgee no longer has control over the object.[260] A pledgee is a secured creditor in terms of section 2 of the Insolvency Act[261] and ranks *pari passu* with other secured creditors. Linked to priority, is the availability of effective enforcement measures to which we now turn.

2.4.5 Enforcement measures in respect of pledges

At the outset, it must be noted that the enforcement measures available for pledges apply equally to notarial bonds discussed *infra* unless specifically otherwise stated.[262] The pledgee can satisfy its claim in terms of the principal debt against the proceeds generated from the sale of the pledged object.[263] Where the pledged object does not fetch a purchase price equal to or more than the outstanding debt, the pledgee will be a concurrent creditor in respect of the amount of the deficit. To get to the stage where the pledged object may be sold, the creditor first requires possession of the pledged object to perfect its security. This contractual right originates from a perfection clause in the pledge agreement and allows the pledgee (creditor) to take possession of the pledged object. The creditor, however, still needs to obtain an attachment order to be able to enforce the perfection clause so excluding extrajudicial proceedings in the attachment of the pledged object. The *parate executie* process potentially allows the pledgee to sell the pledged object without court intervention after having obtained possession[264] and is thematically related to the concept of extrajudicial disposition discussed in Chapters 3 and 4.[265] Both perfection clauses and *parate executie* clauses are discussed *infra* as part of the paragraph dealing with specific clauses relevant to the enforcement of pledges.

Expedited judicial proceedings in the form of a summary judgment application are available. Despite being regarded as an exceptional remedy, courts tend to exercise their discretion in favour of the creditor where a debtor cannot present a reasonable defence to the secured creditor's claim. Although summary judgment proceedings are regarded as an

260 Excluding certain exceptions – eg, where the property is handed to the trustee of the insolvent estate of the debtor.
261 24 of 1936 (the Insolvency Act).
262 See paragraph 2.5.8 *infra* in respect of enforcement measures which apply only to notarial bonds.
263 R Brits *Real Security Law* (2016) at 159.
264 Whether *parate executie* can take place depends on whether the provisions are found to be lawful.
265 See Chapter 3 paragraph 3.3.3.10 *infra* and Chapter 4 paragraphs 4.2.3.2(*h*) and 4.3.3.6 *infra*.

expedited process, the proceedings will still take longer than the expedited judicial proceedings recommended by the OAS Model Law, discussed further in Chapter 4.[266]

2.4.5.1 Judicial proceedings (normal or expedited)

The secured creditor who is not in control of the pledged object must secure an attachment order from a court. The Sheriff of the High Court then takes control of the pledged object as provided in the attachment order.[267] The judicial proceedings discussed apply equally to notarial bonds.

The judgment and attachment orders are obtained through civil proceedings in either a magistrates' court or a High Court, depending on the monetary value of the debt claimed. Where the secured debtor has no defence against the creditor's claim, summary judgment proceedings are an option available to the creditor as the delivery of specified movable property is a circumstance where summary judgment would be appropriate.[268] This procedure does not require full pleadings or a lengthy trial, and provides the creditor with a prompt judgment at an early stage of litigation.[269] Summary judgment proceedings are not necessarily aimed at 'depriv[ing] a defendant with a triable issue or a sustainable defence of her/his day in court'.[270] Nevertheless, granting summary judgment is as an *exceptional* remedy, only granted where it is clear to the court that the creditor's claim is good in law, and the defendant has no legal defence.[271] Moreover, the creditor will only be allowed to apply for a summary judgment in specific circumstances,[272] which includes the delivery of specified movable property.

The defendant in a summary judgment application should have at least ten days' notice of the application, and the notice of the application should be served on the defendant within fifteen days after the defendant delivered her notice of intention to defend.[273] Usually, the summary judgment cannot be brought until the defendant has submitted a notice to defend. Nevertheless, where the defendant fails to deliver a notice of intention to defend, the plaintiff

266 See Chapter 4 paragraph 4.3.3.6(*b*) *infra*.
267 R Brits *Real Security Law* (2016) at 159-160.
268 C Theophilopoulos *et al Fundamental Principles of Civil Procedure* (3rd ed 2015) at 226.
269 C Theophilopoulos *et al Fundamental Principles of Civil Procedure* (3rd ed 2015) at 225.
270 *Joob Joob Investments (Pty) Ltd v Stocks Mavundla Zek Joint Venture* 2009 (5) SA 1 (SCA) para 32.
271 *Shackleton Credit Management (Pty) Ltd v Microzone Trading 88 CC* [2011] 1 All SA 427 (KZP) para 26.
272 C Theophilopoulos *et al Fundamental Principles of Civil Procedure* (3rd ed 2015) at 226.
273 See C Theophilopoulos *et al Fundamental Principles of Civil Procedure* (3rd ed 2015) n 15 at 227.

can apply for a default judgment.[274] The rules governing the process of summary execution have proved to be challenging, for both South Africa and other developing countries.[275]

Summary judgment proceedings could qualify as a form of expedited enforcement measures referred to in the UNCITRAL Guide and the OAS Model Inter-American Law on Secured Transactions (OAS Model Law). Nevertheless, summary judgment proceedings would take longer than the expedited proceedings recommended in the OAS Model Law.[276]

2.4.5.2 Solvent or insolvent debtor

There are distinct steps which form part of enforcement in the case of both a solvent and an insolvent debtor.

(a) Solvent debtor

A creditor must take possession of the pledged property to perfect its security under the pledge. Where the creditor needs to obtain control of the pledged object after default by the debtor, the creditor may claim specific performance using the *actio pigneratica contraria* and request a court order allowing her to attach the pledged object.[277] During the period between the default and the application for specific performance, the debtor may damage or remove the pledged object from the reach of the creditor. To prevent this, the creditor can apply for an urgent interdict to guard against this risk, or request that the pledged object be placed in the possession of a third party for safekeeping and effectively perfect the pledge. The interdict will then qualify as an interim measure available to the creditor.

Where the pledgee already has lawful control over the pledged object, it is still possible for the solvent debtor to object to the sale and the creditor will need the court's permission before she may sell the pledged object.[278] The pledge agreement may, however, include a provision preventing the debtor from objecting to a *lawful* sale.

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274 C Theophilopoulos *et al Fundamental Principles of Civil Procedure* (3rd ed 2015) at 227.

275 For example, see AM Garro 'The OAS-sponsored Model Law on Secured Transactions: gestation and implementation' (2010) 15 *Unif L Rev* 391 at 411 for a similar challenge experienced in Mexico. The author mentions that other countries introduced the intervention of a notary public to expedite the procedure (eg, Peru, Guatemala and Hondurus).

276 Chapter 3 paragraph 4.3.3.6 *infra*.

277 See R Brits *Real Security Law* (2016) at 119 and the reference to *Roos v Ross & Co* 1917 CPD 303.

278 Accordingly, *parate executie* cannot take place. *Parate executie* is discussed in detail *infra*.

Where another judgment creditor seeks to attach the pledged object that is under the lawful control of the pledgee, the pledgee cannot necessarily prevent such attachment, but the judgment creditor's claim is subject to the pledgee's secured claim.[279] The attachment by that judgment creditor creates a so-called 'judicial pledge' which creates a secured claim in favour of the judgment creditor.[280] However, as secured creditors are ranked *pari passu*, the judgment creditor will only be paid from the proceeds of the sale after the pledgee's claim has been satisfied.[281]

(b) Insolvent debtor

The pledged object forms part of the debtor's insolvent estate subject to the pledge being perfected.[282] A pledgee will, therefore, have a secured claim to the proceeds from the sale of the pledged object. These proceeds may be used towards settling the outstanding debt and accrued interest. Where the proceeds of the sale of the pledged object are insufficient to extinguish the debt, the pledgee has a concurrent claim against the insolvent estate for the balance.

The secured creditor may realise the pledged property, depending on whether the type of object allows for this and whether the trustee or liquidator has given permission for the disposition. If the movable property is either securities (which would include shares),[283] a bill of exchange, or a financial instrument or a foreign financial instrument,[284] the creditor can realise the property, but only after having given the trustee notice.[285] All of these types of movable property are incorporeal, and in all likelihood, the creditor would already have the documents which would allow her to exercise control over them[286] and security would also already have been perfected. A trustee is not entitled to take over any of these type of movable property unless the creditor has elected not to make use of this right of disposition. Where the special notarial bondholder, in respect of *incorporeals,* has not taken control of the property to

279 See R Brits *Real Security Law* (2016) and the case law in n 290 at 161.
280 Under the UNCITRAL Guide the judgment creditor becomes a secured creditor and is just ranked below the acquisition finance secured creditor.
281 See R Brits *Real Security Law* (2016) and the case law in n 293 at 161.
282 If the pledge has not been perfected, the creditor will have a concurrent claim against the insolvent estate.
283 Defined in s 1(*a*) of the Financial Markets Act 19 of 2012 (the Financial Markets Act).
284 Financial instrument is defined in s 1(1) of the Financial Sector Regulation Act 9 of 2017 (the Financial Sector Regulation Act).
285 Section 83(2) of the Insolvency Act.
286 Keeping in mind that the security involved cession *in securitatem debiti* of incorporeal movable property.

perfect her security she enjoys no preference in insolvency.[287] However, section 83 of the Insolvency Act allows a creditor holding incorporeal movable property as security to realise this property, subject to compliance with the provisions of this section. This assumes that the right has been perfected and the creditor is a secured creditor for the purposes of the Insolvency Act.[288] The first requirement is that before the second creditor's meeting takes place, the creditor must give notice that she holds movable property as security for her claim to both the Master of the High Court and the trustee of the debtor's insolvent estate.[289] Due to the specific nature of certain movable property, such as securities as defined in section 1(1) of the Financial Markets Act, 'a bill of exchange, a financial instrument, or a foreign financial instrument' as defined in section 1(1) of the Financial Sector Regulation Act, the creditor may proceed to sell these assets subject to the method prescribed in section 83(8). In respect of property not included in the above list, the trustee of the insolvent estate can either: (1) take over the property at a value agreed to with the creditor or the full amount of the creditor's claim; or (2) where the trustee does not take over the property within either seven days of appointment or receiving the initial notice from the creditor, realise the property again subject to the methods prescribed in section 83(8).

It is also possible that granting a pledge may attract provisions of the Insolvency Act concerning voidable transactions. As regards security over future assets, a secured creditor may receive preferential treatment above secured creditors with an earlier existing security right. Accordingly, voidable preferences in insolvency law balance out this risk.[290] The discussion in respect of impeachable dispositions (meaning the validity of a transaction is called into question) is not taken further save for highlighting that where either the grant or implementation of a real security amounts to an impeachable disposition, this may lead to a voidable preference on the debtor's insolvency and effectively render the secured transaction void.[291]

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287 S Scott 'Notarial bonds and insolvency' (1995) 58 *THRHR* at 682 correctly states that this position in the *Cooper* judgment still stands.

288 This means that the security must already be perfected, and the creditor must have control over the incorporeals.

289 Section 83(1) of the Insolvency Act.

290 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 141.

291 Impeachable transactions under the Insolvency Act relevant to this discussion include voidable preferences (where disposition prefers one creditor above another) in terms of s 29; undue preferences (a disposition intended to prefer one creditor) in terms of s 30; collusive dealings (disposition which prejudices creditors or prefers one creditor) in terms of s 31; and void transfers of a business, or of property that formed part of this transfer, in terms of s 34. See also JC Sonnekus 'Borgverbande oftewel algemene notariële verbande en borgstelling: *Van der Walt v Le Roux* 4 All SA 476 (O)' 2005 *TSAR* 609 at 617, 618, discussing the

2.4.5.3 Specific contractual clauses relevant to enforcement: introduction and perfection clauses

A pledge agreement may include specific contractual clauses which regulate aspects of enforcement contractually. These clauses include a perfection clause, a *quasi*-conditional sale clause (as opposed to a *pactum commissorium* or forfeiture clause),[292] and a *parate executie* clause (summary execution clause). [293] A pledge agreement can include all three clauses as enforcement alternatives available to the creditor.

A perfection clause is 'an agreement to create a pledge'.[294] The pledge agreement [295] does not, by operation of law, give the creditor a right to take possession of the collateral. In simple terms, without judicial intervention the creditor does not have an *automatic* right to take possession of the collateral.[296] Consequently, a perfection clause cannot amount to self-help.[297] Usually, the entitlement to take possession originates from a contractual perfection clause.[298] 'Entitlement' refers not only to the general right of possession, but also to the specific circumstances that would result in this entitlement to take possession of the collateral (ie, trigger-events).[299] Accordingly, the agreement must either include a clause which entitles the creditor to take possession to perfect (complete) its security or, in very limited circumstances,

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application of specifically ss 29 and 30 to the perfection of the security under a general notarial bond. See also *Jackson v Louw NO* 2019 JDR 0015 (ECG) para 79 concerning a special notarial bond that was declared void as the agreement amounted to a voidable preference in terms of s 29(1) of the Insolvency Act, thus an example of an impeachable disposition. See also *Cooper v Merchant Trade Finance Ltd* 2000 (3) SA 1009 (SCA) para 18 of Zulman JA's judgment at 1032D - E/F. The crux is that there had to be a subjective intention to prefer one creditor above another. Where perfection took place to comply with a contractual obligation—the perfection clause— there is no 'intention to prefer' as required by s 29 of the Insolvency Act. Further see R Sharrock *et al Hockly's Insolvency Law* (9th ed 2012) at 140-148.

292 As mentioned above, there is a prohibition under South African law against include a *pactum commissorium* clause. This is a contractual right that the pledgee can take over ('acquire') the pledged article without mention of obtaining it at a fair price. See also H Schulze '*Parate executie* and public policy. The Supreme Court of Appeal provides further guidelines' (2005) 26 *Obiter* 710 at 716 where the author explains the difference between a forfeiture clause and a *quasi*-conditional sale. This distinction is clarified *infra* in paragraph 2.4.5.6.

293 These clauses were distinguished in *Bock v Duburoro Investments (Pty) Ltd* 2004 (2) SA 242 (SCA) (the *Bock* judgment) para 6.

294 This applies equally in respect of perfection of both traditional pledges and general notarial bonds (which become a pledge when perfection takes place). Accordingly, reference to the perfection of notarial bonds is included in this paragraph.

295 Also relevant in respect of a notarial bond. See J Roos 'The perfecting of securities held under a general notarial bond' (1995) 112 *SALJ* 169 at 169.

296 J Roos 'The perfecting of securities held under a general notarial bond' (1995) 112 *SALJ* 169 at 169.

297 R Brits *Real Security Law* (2016) at 213.

298 See Van Dijkhorst J in *Eerste Nasionale Bank v Schulenburg* 1992 (2) SA 827 (T) at 828H. See also *Boland Bank Ltd v Vermeulen* 1993 (2) SA 241 (E)(the *Boland Bank v Vermeulen* judgment) at 243G. Both judgments apply to general notarial bonds.

299 R Brits *Real Security Law* (2016) at 216.

where the agreement (pledge agreement or bond document) contains no such clause the right to possession could be a tacit term.[300] Even where there is such a clause in the agreement, the court still has the discretion to refuse the application requesting specific performance.[301] Generally, courts exercise their discretion in favour of the pledgee (including the general notarial bondholder) who has no way of completing her security other than by receiving possession of the bonded property.[302] In exercising its discretion, the court aims to prevent injustice. For that reason, it will rarely happen that a court dismisses such an application provided that the possessory clause justifies the relief claimed, and the parties have complied with the suspensive condition which resulted in the entitlement.[303] Consequently, a court order for specific performance of the perfection clause will instruct the debtor to hand over possession to the creditor. This application is brought *ex parte* due to the urgency of the matter.[304] Obtaining a court order would, therefore, be a response to the debtor's refusal to deliver the pledged property to the bondholder voluntarily.[305]

In the case of an expedited judicial process, an interim order is initially granted. Where an interim attachment order has been granted followed by an interim sequestration order, one may ask whether it is still possible for the interim perfection order to be made final.[306] The current position is summarised as follows. Possession is required to perfect the pledge or general notarial bond. Where possession is lawfully obtained, the security is perfected regardless of the possession having been granted in terms of an interim order. 'Lawful possession' is only reversed where the *causa* for the interim order was 'unlawful'. The order

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300 However, Van Dijkhorst J held in *Boland Bank Ltd v Spies* 1993 (1) SA 402 (T) at 404 and *Eerste Nasionale Bank van SA Bpk v Schulenburg* 1992 (2) SA 827 (T) at 828H, that most general notarial bonds include a perfection clause, and where a bond does not include such a clause, it is very likely that the parties did not intend this clause to be included in the document. I argue that it was potentially not included due to the error of the notary and conveyancer who prepared and registered the bond.

301 Nevertheless, the discretion should be limited and should only be refused when the creditor has an alternative remedy. A claim for damages should not replace a claim for real security. See Harms JA in *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd* 2003 (2) SA 253 (SCA) (the *Contract Forwarding appeal*) para 10.

302 See *Barclays National Bank Ltd & another v Natal Fire Extinguisher Manufacturing Co (Pty) Ltd* 1982 (4) SA 650 (D) at 656D-E. This case applied to a general notarial bond.

303 J Roos 'The perfecting of securities held under a general notarial bond' (1995) 112 *SALJ* 169 at 179.

304 J Roos 'The perfecting of securities held under a general notarial bond' (1995) 112 *SALJ* 169 at 169.

305 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 267 and the sources listed at n 92. See also, *Boland Bank v Vermeulen* judgment at 243F. See further, M Jansen 'More legal security regarding security by means of general notarial bond' (2003) 15 *SA Merc LJ* 486 at 489. The legal nature of a perfection clause applies equally to a general notarial bond.

306 *Chesterfin (Pty) Ltd v Contract Forwarding (Pty) Ltd* 2002 (1) SA 155 (T); and *Contract Forwarding appeal*. See also M Jansen 'More legal security regarding security by means of general notarial bond' (2003) 15 *SA Merc LJ* 486 at 486-497 and M Jansen 'Security by means of general notarial bonds' (2003) 11 *JBL* 154 at 154-158 where she discusses the *Contract Forwarding appeal*.

itself does not perfect the security but allows lawful possession of the pledged or bonded object, which results in the perfection of the security.[307]

Another potential issue is whether a perfection clause withstands constitutional muster. An interim perfection order is a rule *nisi* which must be confirmed by a final order. Consequently, the debtor will have access to a court – as guaranteed by section 34 of the Constitution – to complain about potential prejudice before the order becomes final.[308] Accordingly, it cannot be said with conviction that the provisions of a perfection clause are unconstitutional *per se*. A perfection order can never allow self-help as this would be unconstitutional. However, where possession is lawful, either due to the application of a court order or where the debtor voluntarily parts with the hypothecated property, the debtor still has access to a court to dispute any prejudice potentially suffered due to the perfection of the security.

The next two paragraphs address two other types of clause (relating to enforcement) that can be included in the pledge agreement: *parate executie* which entails selling the collateral without further court intervention; and *quasi*-conditional sale which involves the creditor taking over (or 'buying') the property at a fair price.

2.4.5.4 Specific contractual clauses relevant to enforcement: *parate executie*

Summary execution means selling the encumbered property without court intervention when the debtor is in default and the creditor is already in control of the property. It has been said that the principle in favour of summary execution has been interpreted more strictly in South Africa in the recent years.[309] Nevertheless, the general rule in terms of common law is that a *parate executie* clause is valid and enforceable in pledge agreements dealing with movable property provided that the pledgee has lawful possession of the pledged object.[310] Regardless

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307 JC Sonnekus 'Perfektering van algemene notariële verbande en loon vir laatslapers' 2002 *TSAR* 567 at 568. Even though the article deals with notarial bonds, the principles apply equally to pledges.

308 In terms of this section everyone has a right for their dispute to be resolved by application of the law in a 'fair public hearing'. This can either be by a court or, where appropriate, another tribunal or forum (that is independent and impartial).

309 L Ntsoane & M Wiese 'A comparative overview of the legal reform of non-possessory real security rights over movables in South Africa and Belgium with specific reference to the legal nature of the security object and court intervention' (2017) 29 *SA Merc LJ* 325 at 350.

310 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 122, 123. The Supreme Court of Appeal confirmed the constitutionality of *parate executie* in the *Bock* judgment para 15. However, *parate executie* is not permitted in respect of immovable property. See *Iscor Housing Utility Co v Chief Registrar of Deeds* 1971 (1) SA 613 (T), approved in the *Bock* judgment para 7.

of *parate executie* taking place, nothing prevents the debtor from approaching a court where the creditor has acted in a manner which has prejudiced the debtor's rights.[311] Accordingly, there should be a distinction 'between the validity of a clause and its enforceability'.[312] The discussion *infra* also applies to notarial bonds.

Parate executie can only take place after the real security right under a pledge has been perfected.[313] Perfection requires that the secured creditor already has *lawful* possession of the pledged object. Furthermore, *parate executie* can only take place if the parties agree to the execution.[314] Consequently, there can be no question of involuntary dispossession as the debtor has *already* voluntarily parted with the pledged object and agreed that the execution may take place.[315]

The discussion *infra* concerning *parate executie* is structured according to the following themes: (1) the extent which debtor's consent to the sale influences the lawfulness of *parate executie*; (2) whether *parate executie* can withstand constitutional muster; and (3) the extent to which specific statutory provisions regulate *parate executie* measures concerning pledges.

(a) Influence of the debtor's consent on the lawfulness of parate executie

One cannot regard *parate executie* as 'self-help' if the creditor is acting with the full consent of the debtor in selling the encumbered property. The debtor's consent is included in her acceptance of the *parate executie* (or summary execution) clause which formed part of the pledge agreement. This clause is generally regarded as permissible as a person who 'is willing to part with her property voluntarily' against *reasonable* contractual terms, must be allowed to

311 *Osry v Hirsch, Loubser & Co Ltd* 1922 CPD 531 (the *Osry* judgment) at 547. On the validity of summary execution under common law, also see *Aitken v Miller* 1951 (1) SA 153 (SR); and *Sakala v Wamambo* 1991 (4) SA 144 (ZHC). See further, H Schulze '*Parate executie* and public policy. The Supreme Court of Appeal provides further guidelines' (2005) 26 *Obiter* 710 at 718 and also the reference to this principle in the *Bock* judgment para 13.

312 R Brits *Real Security Law* (2016) at 174. The author explains that even though the clause itself may be valid, the creditor's reliance on the clause could be unlawful in that particular instance.

313 See the *Bock* judgment para 14 where the court refers to the 'sensible distinction' between the pledged object being either 'in the hands of the debtor' or 'in the hands of the creditor'.

314 S Scott 'A comparison between Belgian, Dutch and South African law dealing with pledge and execution measures' (2010) 43 *CILSA* 1 at 20.

315 S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 657. See also, S Scott 'A private-law dinosaur's evaluation of summary execution clauses in the light of the Constitution' (2007) 70 *THRHR* 289 at 291 where the author emphasises the fact that a debtor has already parted with her property of her own free will.

do so, and there is no element of 'self-help'.[316] Thus, under *parate executie* there is no involuntary dispossession of the debtor.[317] Potentially, allowing the inclusion of this clause extends party autonomy to the enforcement measures. The moment of consent is different for pledges and other mortgages (including notarial bonds). In the case of a mortgage in respect of movable property, the authority must be obtained *after* default.[318] However, under a pledge agreement the consent can take place either: (1) after perfection; or (2) even *before* default.

However, a summary execution clause in a pledge agreement will be unlawful under certain circumstances. A *parate executie* clause is unlawful where it is either: (1) contrary to public policy and so unenforceable under common law;[319] (2) contrary to a statutory provision;[320] or (3) where the clause is unconstitutional. The different circumstances are discussed *infra*.

(b) Public policy and constitutionality of parate executie

The constitutionality of *parate executie* has been questioned in South Africa. For purposes of this study, it is unnecessary to venture into a detailed analysis of the constitutionality of summary execution, but I shall instead accept the current precedent that *parate executie* remains constitutionally valid in respect of movable property.[321]

The constitutionality of *parate executie* is challenged on the basis that it supposedly infringes on the right of access to courts guaranteed in section 34 of the Constitution. This provision guarantees the right for a *dispute* to be adjudicated before a court. Consequently, where a debtor has *voluntarily* parted with the hypothecated property to the creditor, there is

316 S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 663. Also, the *Bock* judgment para 7 confirmed this position adopted in the *Osry* judgment. See further R Brits *Real Security Law* (2016) at 173 and the reference to these judgments.

317 This is in contrast with involuntary dispossession which takes place under statutes which empower the state to seize movable property. See S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 658 regarding this comparison.

318 See S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 658 regarding this comparison.

319 This will be the case where the *parate executie* is unconscionable or not compatible with public policy (see *SA Bank of Athens Ltd* judgment para 10).

320 An example is where a *parate executie* clause amounts to unlawful conduct in terms of s 90 of the NCA.

321 The constitutionality of *parate executie* in respect of movable property was confirmed by the Supreme Court of Appeal in the *Bock* judgment para 15.

generally no dispute to adjudicate. The only possible legal dispute may relate to whether the debt is indeed due and payable and probably also what amount is due and payable.

The purpose of judicial intervention is to prevent potential prejudice the pledgor may suffer. The risk of prejudice is mitigated where the debtor can approach the court when she feels that she has suffered prejudice.[322] Even where there is lawful possession, nothing prevents the pledgor from approaching a court where the possession may potentially prejudice her,[323] or where the enforcement of a *parate executie* clause is against public policy and therefore un-enforceable.[324] For example, a clause allowing the creditor to determine when the debtor defaulted could be against public policy.[325] The common law only needs to be developed where it clashes with the provisions of the Constitution.[326] In the case of lawful *parate executie*, the current position is that the common law is in line with the Constitution and thus,[327] unless convincing new arguments are presented, such clauses will remain valid in respect of movable property.

(c) Parate executie *and statutory provisions*

A *parate executie* clause may be unlawful if it contravenes a statutory provision. An example is a *parate executie* clause included in a credit agreement which falls within the scope of the NCA.[328] This, in turn, depends on whether the secured transactions involves either a pawn transaction or a secured loan under the NCA.

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322 See S Scott 'Die bronne van die Suid-Afrikaanse sakereg en die invloed van die Grondwet van die Republiek van Suid-Afrika, 1996, op die regsontwikkeling in hierdie gebied van die privaatreg' 2014 *TSAR* 1 at 22, 23. However, according to some authors the ability of the debtor does not remedy the mischief and cure the limitation of the right. See S Cook & G Quixley '*Parate executie* clauses: is the debate dead?' (2004) 121 *SALJ* 719 at 725. However, I agree with Brits that a proper constitutional analysis has not been undertaken and should form the topic of future research. See R Brits 'Pledge of movables under the National Credit Act: secured loans, pawn transactions and summary execution clauses' (2013) 25 *SA Merc LJ* 555 at 575. Consequently, for so long as the debtor has access to defend her rights after *parate executie* has taken place, the right of access to a court remains protected.

323 *Bock* judgment para 8.

324 See the reference in R Brits *Real Security Law* (2016) at 174 to *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A) 13-14.

325 See *SA Bank of Athens Ltd* at 98H-I.

326 JC Sonnekus 'Onverwagte raakpunte tussen menseregte en saaklike sekerheidsregte?' 2002 *Tijdschrift voor Privaatrecht* 1 at 12 also states that private law already contains principles which allow for a reasonable balance between parties to be achieved and reference to the bill of rights will not always be required.

327 *SA Bank of Athens Ltd* judgment paras 11-16. See also R Brits *Real Security Law* (2016) at 174 confirming this as the current position under these judgments.

328 R Brits *Real Security Rights* (2016) at 175. The discussion relates to secured loans and pawn transactions which both involve pledge. See also R Brits 'Pledge of movables under the National Credit Act: secured loans, pawn transactions and summary execution clauses' (2013) 25 *SA Merc LJ* 555 at 556.

The definition for a pawn transaction *specifically* allows summary execution 'on expiry of a defined period'.[329] Consequently, summary execution is lawful in case of a pawn transaction. This is further supported by the fact that those sections in the NCA dealing with 'unlawful contractual provisions' which form part of a credit agreement, do not apply to pawn transactions.[330] Nevertheless, a *parate executie* clause included in a secured loan subject to the NCA, remains a potentially 'unlawful contractual provision' within the meaning of section 90(2) of the NCA.[331]

Despite the application of the NCA, many secured transactions take place outside of the consumer context – eg, through legal entities. In most of these instances, the NCA does not apply. The result is that South African law knows two different approaches to *parate executie*: the NCA prohibits its use in the consumer credit sphere; but the common law allows it in the commercial (non-consumer) realm. However, this distinction correctly considers the special protection consumer credit legislation must afford to a designated group of the population, which is also the position elsewhere.[332] The international and regional instruments discussed in Chapters 3 and 4, specifically exclude consumer goods from the secured transactions law framework, which is also the approach adopted in this study.

2.4.5.5 Specific contractual clauses relevant to enforcement: *pactum commissorium* and *quasi*-conditional sale

Two types of disposition clause, a *pactum commissorium* (forfeiture clause) and a *quasi*-conditional sale clause, are on occasion confused.[333] In both instances assets are 'taken over' by a secured creditor in satisfaction of an outstanding debt, but the difference lies in whether the exchange takes place against a fair asset value or not. The content of the different provisions

329 Section 1 of the NCA.

330 The policy decision to exclude pawn transactions is sound. This first relates to the small monetary value of pawn transactions and also the traditional purpose of securing small transactions with low value assets. Also, enforcement proceedings in pawn transactions need not follow the enforcement proceedings under s 130 of the NCA.

331 In this regard, either s 90(2)*(j)*, concerning the agency provisions, or s 90(2)*(k)*, which deals with providing the creditor with a power of attorney, is potentially relevant. See R Brits 'Pledge of movables under the National Credit Act: secured loans, pawn transactions and summary execution clauses' (2013) 25 *SA Merc LJ* 555 at 567-573.

332 For example, under art 46 of the Belgian Pledge Act of 11 July 2013.

333 Clarity came with the Appellate Division's decision in *Mapenduka v Ashington* 1919 AD 343 (the *Mapenduka* judgment), confirmed in *Graf v Buechel* 2003 (4) SA 378 (SCA) (the *Graf* judgment). See also the discussion of the *Mapenduka* judgment in R Brits *Real Security Law* (2016) at 167-170. See further, S Scott '*Pacta commissoria* (vervalbedinge en pandreg)' 2010 *TSAR* 779 at 786.

is discussed *infra* to clarify the dissimilar legal nature of these types of clause in security contracts.

The *pactum commissorium* is an agreement which allows the pledgee to 'keep the security as his own property' if the debtor defaults[334] while disregarding the value of the property in context of the outstanding debt.[335] A *pactum commissorium* was prohibited under both Roman[336] and Roman-Dutch law.[337] This prohibition on *pacta commissoria* is also found in other legal jurisdictions.[338] Under current South African law, the *pactum* is 'illegal and unenforceable'.[339] *Pacta commissoria* are prohibited on the basis of the potential prejudice they hold for debtors, but it has been submitted that other considerations – eg, the effect on the debtor's other creditors and the prohibition of unjustified enrichment of the creditor – should also be considered.[340] The potential prejudice results from the creditor exploiting the weaker position of the debt-stricken debtor and retaining an asset where the value or importance of the asset is potentially higher than the actual outstanding debt.[341] Nevertheless, there is a possibility of allowing a *pactum commissorium* in the case of pawn transactions subject to the NCA.[342] Usually, the value of a pawned item closely corresponds to the outstanding debt and the loan period is also typically short. This considerably reduces possible prejudice that the debtor could suffer. The use of *pacta commissoria* in South Africa should not be extended beyond their application to pawn transactions.

The pledge agreement may contain a clause providing that as soon as the debtor defaults, the pledgee may acquire the pledged property against a just or fair (the terms are used interchangeably in case law) price determinable at that time.[343] This type of provision will

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334 The *Graf* judgment para 9.

335 R Brits *Real Security Law* (2016) at 162.

336 *Meyer v Hessling* 1992 (4) SA 286 (NmS) at 286G and the *Graf* judgment para 9. This prohibition has also survived in legal systems that follow a civil law or mixed legal traditions (eg, the Philippines Civil Code and RP de Vera 'How much credit is there in a promise: forging a unified law on secured transactions' (2008) 83 *Phil L J* at 236 at 259 in this regard).

337 *Graf* judgment paras 9-11.

338 This practice is also prohibited in France, Germany, Belgium, and the Netherlands. See the synopsis by Cloete JA of the position under these jurisdictions in the *Graf* judgment paras 20-24.

339 This principle enunciated in the *Graf* judgment was confirmed in the *Bock* judgment para 13. See also the discussion of the prohibition of such clauses under Roman law and Roman-Dutch law in TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 124. See further, R Brits *Real Security Law* (2016) and the sources confirming the prohibition in n 307 at 164.

340 S Scott '*Pacta commissoria* (vervalbedinge en pandreg)' 2010 *TSAR* 779 at 783.

341 R Brits *Real Security Law* (2016) at 165 and the reference at 124 in TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) to Voet who described this remedy as 'harsh and replete with injustice'.

342 R Brits *Real Security Law* (2016) at 176.

343 See the *Mapenduka* judgment at 358 and the *Graf* judgment para 9. See also R Brits *Real Security Law* (2016) at 166.

amount to a *quasi*-conditional sale regulated by common law.[344] The requirements for a *quasi*-conditional sale clause which distinguish it from a *pactum commissorium* are: (1) that the former attributes a fair or just (the term used in the *Mapenduka* judgment) *value* to the pledged property when the asset is 'taken over' as a buyer by the pledgee (it is doctrinally correct to say the creditor buys the pledged object), thus not the value when the agreement was concluded;[345] and (2) this value is determined *after* the debtor defaults.[346] The clarity provided in the *Mapunduka* judgment as regards the distinction between the distinguishing factors mentioned *supra*, has been confirmed by subsequent authority and remains the current position under South African law.[347] Brits adds a possible third requirement after considering the Supreme Court of Appeal decision in the *Graf* judgment. This third requirement relates to whether the consent to *quasi*-conditional sale against a fair value can be included in the pledge agreement, or whether the pledgor must again consent to this conditional sale after she defaults. The current legal position regards to the inclusion of the consent in the pledge agreement to be sufficient and subsequent unwillingness has no effect.[348]

As stated above, the crux of the difference between the *quasi*-conditional sale and a *pactum commissorium*, relates to attributing a fair value to the asset that is taken over by the creditor, which is the case with the former but not the latter.[349] Determining what is 'fair' is a factual question.[350] Relevant factors that influence what is regarded as 'fair' include: (1) the market practice in selling the specific asset; and (2) what is regarded by both parties as a fair

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344 Nevertheless, in terms of s 127 of the NCA, the consumer's right to surrender the hypothecated goods potentially qualifies as statutory version of a *quasi*-conditional sale. Section 127 requires that the credit provider first provide the 'estimated value of the goods', and where the consumer fails to respond to the creditor's valuation notice, 'the best price reasonably obtainable' must be secured (s 127(4)(*b*) of the NCA). The discussion of s 127, a consumer credit law provision, is not taken further as the secured transaction law frameworks generally do not extend to consumer goods.

345 Here the reference is to 'taking over' the property, which corresponds to the term used in the legal frameworks in Chapters 3 and 4 *infra*. It is theoretically incorrect to say that the creditor keeps the property. It could be said that the creditor elects to 'buy' the property and ownership passes when the value of the property is subtracted from the debt due at that time. See R Brits *Real Security Law* (2016) at 169, 170.

346 See in this regard the *Mapunduka* judgment at 352-358, the *Bock* judgment para 9, and the *Graf* judgment paras 27-29. See also, R Brits *Real Security Law* (2016) at 166 and specifically the sources listed in n 319.

347 See R Brits *Real Security Law* (2016) at 167,168 for a summary of Appellate Division's (as it then was) reference to Voet and the *Codex* and Digest. See also, confirmation of the decision in the *Graf* judgment paras 28-29 and *Bock* judgment para 9 which affirm the original principle in the *Graf* judgment.

348 This is the conclusion is reached in the *Graf* judgment paras 27-29 and confirmed in the *Bock* judgment para 9. See R Brits *Real Security* Law (2016) at 169. Nevertheless, according to Scott, the willingness after default raised in the *Mapenduka* judgment, is still the current authority. See S Scott '*Pacta commissoria* (vervalbedinge en pandreg)' 2010 *TSAR* at 779-789,787-788.

349 The discussion of the international and regional instruments Chapters 3 and 4 *infra*, in most instances reflects that *pactum commissorium* should still not be allowed in that taking-over collateral is always subject to determining a fair price. See Chapter 5 paragraph 5.4.7.1(*c*) *infra* where the possibility of some legal instruments being perceived to include *pactum commissorium* is discussed.

350 The EBRD Model includes the standard of a fair value. See Chapter 4 paragraph 4.2.3.2(*h*) *infra.*

method by which to determine asset value. A potential standard to consider is what a commercially reasonable value would be. This is explored further in Chapter 5.

A *quasi*-conditional sale occurs in respect of incorporeal movable property, especially in respect of pledged shares, where the creditor exercises an 'option' to purchase the pledged shares.[351] It was mentioned *supra* that incorporeal movable property, like shares and book debts, are pledged using cession *in securitatem debiti*, which is briefly discussed in the next paragraph.

2.4.6 Cession *in securitatem debiti* of personal rights (claims)

It is not the aim of this paragraph to provide a detailed discussion of the cession *in securitatem debiti* as this will detract from the ultimate focus of the study which is on corporeal movable property. Nevertheless, as book debts and financial instruments (eg, shares) are often used as security in secured transactions, the current law concerning this incorporeal movable property should at least be considered when recommending reform to the South African legal framework in respect of security rights in movable property.

Arguably, cession has a dual character in that it forms part of the law of obligations (the purpose is to effect substitution of creditors) and of the law of property (as there is *quasi*-delivery or transfer of the personal right involved).[352] In simple terms, cession *in securitatem debiti* refers to an act of transfer where the object – a personal right – is transferred by a creditor (the cedent) to a third party (a cessionary) through an agreement (a transfer agreement) in order to secure an obligation.[353] The obligation can be either an existing or future obligation.[354] The incorporeal thing (the personal right) is transferred through the cession of actions. This implies that the cessionary now becomes the creditor (the person who holds the personal right) and steps into the shoes, so to speak, of the original creditor.[355] The cession takes place without the consent of the original debtor to the claim as South African law does not require publicity in

351 *Osry* judgment at 546, 547, also referred to in the *Bock* judgment para 9.

352 See S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 21-23 on the difference in case law and academic writing regarding the recognition of the dual nature of cession. See also, GF Lubbe 'Cession' in WA Joubert & JA Faris (eds) *LAWSA* Vol 3 (3rd ed 2013) para 136.

353 S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 25.

354 Essentially there can be an obligatory agreement (*pactum de cedendo*) for the cession to take place in the future, and the real agreement of cession (*pactum cessionis*), but these agreements are usually included in a single document. See GF Lubbe 'Cession' in WA Joubert & JA Faris (eds) *LAWSA* Vol 3 (3rd ed 2013) para 179.

355 S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 120.

this instance.[356] The argument goes that the debtor need not be informed of the cession, as she is in any event protected where payment is made to the original creditor.[357] Thus, transfer of the personal right takes place by agreement with the 'meeting of minds' of the cedent and cessionary.[358] It is not possible to 'deliver' a personal right to a claim in the traditional sense and accordingly this right is ceded. Brits provides a practical, albeit fictional, explanation of a secured transaction using personal rights as security.[359] Following the suggested approach, the claim is regarded as an 'object', which is a thing capable of being owned and in which a non-owner may acquire a right similar to a limited real right in the personal right 'owned' by another.[360] The limited real right is constituted where the cessionary (the person taking security in the personal right through cession) obtains legal control of the object ceded (the right). The cedent (the person who cedes the personal right to the cessionary as security) must be completely divested of the right (or ability) to enforce the personal right (claim). Accordingly, only the cessionary (or pledgee) must have *locus standi* to enforce the personal claim against the original debtor.[361] It is not possible to cede a right to several cessionaries.[362]

The scope of personal rights that may be ceded appears wide. Examples of cedable personal rights often used in commerce, include the personal rights embodied in shares, personal rights arising from a lease agreement, and personal rights arising from book debts (or receivables as referred to outside of South Africa).[363] Even though it is not without controversy, it is possible to cede a future right (for example cession of future book debts),[364] which adds to the commercial value of cession. The best approach is to regard this transaction as cession in anticipation.[365] Accordingly, the limited real right in the claim exists from the moment this personal claim comes into existence.

Cession *in securitatem debiti* denotes either an out-and-out security cession (also referred to as a fiduciary security cession) or a pledge of personal rights (the pledge construction).[366]

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356 See GF Lubbe 'Cession' in WA Joubert & JA Faris (eds) *LAWSA* Vol 3 (3rd ed 2013) para 133 and S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 25, 290.

357 See this position of the debtor described in GF Lubbe 'Cession' in WA Joubert & JA Faris (eds) *LAWSA* Vol 3 (3rd ed 2013) para 181.

358 GF Lubbe 'Cession' in WA Joubert & JA Faris (eds) *LAWSA* Vol 3 (3rd ed 2013) para 132.

359 R Brits *Real Security Rights* (2016) at 324.

360 R Brits *Real Security Rights* (2016) at 324.

361 R Brits *Real Security Rights* (2016) at 328, 329.

362 GF Lubbe 'Cession' in WA Joubert & JA Faris (eds) *LAWSA* Vol 3 (3rd ed 2013) para 147.

363 See the examples listed in S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 139-142.

364 See R Brits *Real Security Rights* (2016) and the sources listed in n 278 at 334.

365 R Brits *Real Security Rights* (2016) at 335.

366 See S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 410 where the 'fiduciary security cession' is used to denote the distinction between an out-and-out cession and a security cession.

Under the pledge construction, the cessionary is presumed to take a limited cession of the claim (assumed to be the equivalent to a limited real right) the cedent has against another for as long as the debt between the cedent and cessionary remains outstanding.[367] The cedent remains the creditor, but the cession divests her of any capacity to enforce the claim she has against another. In effect, the pledge agreement (as the real agreement) creates the obligation to 'deliver' the personal right and, in turn, the 'delivery' then happens upon cession of the personal right.[368] The pledge construct, therefore, involves a 'partial cession' of rights. In respect of the pledge construct, the pledgor remains the 'owner' of the personal right, leaving the pledgee with a something similar to a limited real right in respect of the personal right (the security object).[369] Arguably this type of cession is treated the same as a traditional possessory pledge in respect of corporeal movable property, albeit that there is no actual delivery of the personal right. The crux of this approach is that the bare *dominium* of the right remains in the cedent's estate where cession takes place for security purposes.[370] This also applies in the case of insolvency.

Conversely, the absolute cession theory involves an out-and-out security cession amounting to an outright transfer of the personal right, but subject to a *pactum fiduciae*.[371] This entails that the previous 'owner' of the claim now only has a personal right for the re-cession following the payment of the debt, while the cessionary 'owns' the personal right (as the securing object).[372] Thus, the fiduciary security cession involves a fiduciary act which means that the fiduciary security agreement provides the *causa* for this specific type of cession.[373] Under this construct, the creditor becomes the exclusive holder of the personal right, but only for the limited purpose of securing that an obligation will be fulfilled.[374]

This study will not attempt to determine which theory should apply but assumes that these two types of cession co-exist. However, the courts have favoured the pledge construct as the more modern and commercially relevant alternative,[375] and also acknowledge the negative

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367 R Brits *Real Security Rights* (2016) at 277; GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 414.

368 R Brits *Real Security Rights* (2016) at 278.

369 R Brits *Real Security Rights* (2016) at 279.

370 GF Lubbe 'Cession' in WA Joubert & JA Faris (eds) *LAWSA* Vol 3 (3rd ed 2013) para 182 and S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 410.

371 GF Lubbe 'Cession' in WA Joubert & JA Faris (eds) *LAWSA* Vol 3 (3rd ed 2013) para 180.

372 R Brits *Real Security Rights* (2016) at 279, 280. See also GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 414.

373 S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 410.

374 S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 412.

375 S Scott 'One hundred years of security cession' (2013) 25 *SA Merc LJ* 513 at 518. The practical approach to using the pledge construct was set out in *National Bank of SA Ltd v Cohen's Trustee* 1911 AD 235 (the *Cohen's Trustee* judgment) at 246-7. This *dictum* is also referred to by Scott with approval (at 523).

consequences that result from the insolvency of the cessionary under the out-and-out security cession construct (the personal right falls into the insolvent estate of the cessionary).[376] We are not dealing with an either-or-approach, and the parties should be – and in terms of current law are under party autonomy – allowed to decide whether the pledge construct or out-and-out cession will be used for their secured transaction. The current authority in *Grobler v Oosthuizen*,[377] follows *National Bank of South Africa Ltd v Cohen's Trustee*[378] where the substance of the cession is preferred over the form. The default position is that the pledge theory applies unless the parties specifically state otherwise.[379] The pledge theory is the more commercially practical option for now. The general approach to secured transactions law reform elsewhere, is to no longer distinguish between outright and the security transfers of receivables, but to include both under a uniform legal framework.[380] However, this option can only be adopted as part of the South African framework where the choice is to reform the entire framework using a unitary approach or a uniform system.[381]

Simple cession of the personal right is required in respect of both theories.[382] However, greater publicity of the transfer of control over the personal right is surely required. In respect of the pledge construction, the assumption is that the cession is the functional equivalent of a possessory pledge in respect of corporeal movable property. But in the case of cession there is no actual delivery, as required for possessory pledges. In essence, a real right exists without publicity, as only a cession (merely a state of mind) is required to transfer control over the personal right. Thus, the cession of the right exists independently from the written document recording the right, and cession takes place without the actual delivery of the document to the cessionary.[383] This does not appear to be problematic for the courts[384] and although a central registry for cession has been mooted, this suggestion has not been pursued.[385] This lack of publicity runs counter to developments elsewhere where, for example, the assignment of

376 GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 414 and S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 421 acknowledge the importance of this negative consequence on the court's reasoning as to which construct to adopt.

377 2009 (5) SA 500 (SCA).

378 1911 AD 235.

379 GF Lubbe 'Cession' in WA Joubert & JA Faris (eds) *LAWSA* Vol 3 (3rd ed 2013) para 180.

380 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 27.

381 See the different option recommended for South African reform in Chapter 5 paragraph 5.4.1.2 *infra.*

382 R Brits *Real Security Rights* (2016) at 303.

383 GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 424.

384 R Brits *Real Security Rights* (2016) at 307.

385 See, for example, the suggestion in *Britz No v Sniegocki* 1989 (4) SA 372 (D) at 380G.

receivables is properly publicised in a public register.[386] It should, however, be noted that even though cession and assignment are functional equivalents, the legal nature of these concepts differs.[387]

As cession involves ceding a claim which the pledgor has against another (the original debtor), there are technically three parties involved in a cession. Currently, the original debtor is not required by law to be notified of the cession of the claim.[388] However, requiring that the original debtor receive notice has merit and consideration should be given to making notice a requirement for a valid cession.[389] It remains possible for the original credit agreement to contain a prohibition on cession. The *pacta de non cedendo*, applies either in the wide sense (cession can only take place subject to certain formalities), or in the narrow sense (where cession is completely prohibited).[390] Where security is provided, it is important to consider the effect of the *pacta de non cedendo* on third-party rights.[391] The *pactum* essentially applies between the original creditor and debtor. But the creditor (cedent) may not – under the *nemo plus iuris transferre potest quam ipse habet* rule – transfer more rights than she has to the cessionary.[392] Accordingly, it is not against public policy to bind the cessionary to the consequences arising from the *pacta de non cedendo.* This prohibition forms part of the essence of the right (the claim which is ceded).

In summary, this condensed examination of cession *in securitatem debiti* highlights that commerce would benefit from using this security device. Nevertheless, the confusion surrounding the exact dividing line between and legal nature of the two constructs – the pledge theory and fiduciary security cession – requires statutory intervention.[393] The rules that apply to possessory pledges cannot equally apply to a pledge of incorporeal movable property where there is no actual transfer of possession. As there is only *quasi*-delivery, there is a complete lack of publicity of the cession which leads to the conclusion that the cessionary cannot be regarded as a pledgee (and a secured creditor) in the traditional sense. Further, in respect of the fiduciary security cession, the unfair position the cedent finds herself in when the cessionary

386 Receivables are included under the UNCITRAL Guide as movable property in which a security right should be registered in order to be effective against a third party. See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 174.
387 S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 72-75.
388 R Brits *Real Security Rights* (2016) at 313. See also S Scott 'Die rol van kennisgewing van sessie aan die skuldenaar' (1979) 42 *THRHR* 155 at 175.
389 S Scott 'Die rol van kennisgewing van sessie aan die skuldenaar' (1979) 42 *THRHR* at 155-177, 158-162.
390 R Brits *Real Security Rights* (2016) at 317.
391 The leading case in this regard is *Paiges v Van Rhyn Gold Mines Estates Ltd* 1920 AD 600 at 615.
392 R Brits *Real Security Rights* (2016) at 320.
393 S Scott *Scott on Cession: A Treatise on the Law in South Africa* (2018) at 465.

goes insolvent, needs to be amended to at least provide the cedent with a secured claim in the proceeds resulting from the sale of the encumbered property.

An alternative is to create a registered non-possessory pledge which includes incorporeal movable property as security.

2.4.7 Non-possessory pledges: a possibility?

Modern commerce requires a non-possessory pledge or a functionally equivalent security device.[394] The commercial disadvantages associated with the use of possessory pledges has forced commerce to find modern alternative security devices which call for a 'catch-up' from lawmakers.[395]

A non-possessory security device can take different forms. First, it may be a general statutory non-possessory pledge which applies to most secured transactions. An alternative is to create a non-possessory pledge with a specific application. This focused type of non-possessory pledge can either operate in a specific sector – eg, agriculture,[396] business, the credit industry, or the pawn industry[397] – or the scope of application may be limited to specific transactions involving a specific 'species' of asset, or where the creditor is a financial institution.[398] The form and legal nature will ultimately depend on the key policy objective that the lawmakers aim to achieve by introducing the non-possessory security device.[399]

There are different legislative reform approaches. The first is an integrated approach, where one piece of legislation is adopted which incorporates both possessory and non-

394 South African courts have also alluded to this need. For example, see *Nedcor Bank Ltd v Absa Bank Ltd* 1998 (2) SA 830 (W) at 838G-H.

395 See the concept of 'commercial-legal reform' mooted by Stacy where commerce dictates the legal reform that is adopted. See SP Stacy 'Follow the leader? The utility of UNCITRAL's Legislative Guide on Secured Transactions for developing countries and its call for harmonisation' (2014) 49 *Tex Int' LJ* 35 at 38.

396 Examples of statutory pledges include the pledges under Land and Agricultural Development Bank Act 15 of 2002 (the Land and Agricultural Development Bank Act) and the Co-operatives Act 14 of 2005 (the Co-operatives Act). However, use of this statutory pledge is reserved for the state and co-operatives.

397 In general, see the discussion by S Scott 'A comparison between Belgian, Dutch and South African law Dealing with pledge and execution measures' (2010) 43 *CILSA* at 2-4 of the extended use of the pledge for business under Belgian law before the introduction of the Belgian Pledge Act of the 11 of July 2013. The Belgian *Wet van 25 Oktober 1919* providing for the pledge of a business and *Wet van 15 April 1884* which created a security right for a creditor of a farmer. In these pieces of legislation, provision was made for 'an alternative form of publicity' through the use of a pledge register which was said to have been accessible to anybody.

398 The limited application is suggested by DSP Cronje *Eiendomsvoorbehoud by 'n Huurkontrak van Roerende Sake* (1977) (unpublished LLD-thesis: Rand Afrikaans University) at 12.

399 Chapter 5 *infra* recommends key policy objectives (paragraph 5.3) and fundamental principles (paragraph 5.4) for reforming the South African framework.

possessory pledges. A second approach is to adopt legislation dealing exclusively with non-possessory pledges and leaving our current law on possessory pledges as is – the SALC's initial suggestion.[400] A third option is to retain the fragmented approach but set standardised rules to deal with enforcement, priority, and third-party effectiveness.[401] The preferred approach would be the integrated approach, for the most part, but this would require the common-law position to be included in legislation (ie, codified) and adapted to bring it into line with the characteristics of non-possessory pledges.

The UNCITRAL Guide takes the stance that simply modernising the traditional pledge framework may not be enough.[402] Also, equating notarial bonds under the SMPA to a 'fictitious pledge' was probably not the correct route – creating a *sui generis*-type of security device would arguably have been a better option. Moreover, the rules governing *possessory* pledges cannot equally apply to a non-possessory pledge in all aspects and under all circumstances, even if the latter is regarded as a 'fictitious pledge'.

A key objective of the SMPA was to introduce an effective form of non-possessory real security. However, if legal efficacy is linked to the economic efficacy, special notarial bonds under the SMPA cannot convincingly be regarded as effective. Accordingly, notarial bonds are the topic of the next paragraph.

2.5 Notarial bonds

2.5.1 Introduction

In South African law a notarial bond is a form of real security.[403] Any natural person or entity may grant or be the holder of a notarial bond. A notarial bond finds expression through an agreement between a creditor and debtor, attested by a notary, and registered in a deeds registry, in terms of which the debtor hypothecates movable property in favour of the creditor to secure the performance of a principal obligation.[404] As in the case of a pledge, the bond is accessory

400 See paragraph 2.2 where the 'pand sonder besit' suggested in the SALC discussion paper, is mentioned.

401 These are the three approaches in terms of the UNCITRAL Guide which apply to non-possessory security rights and so can also apply to a non-possessory pledge.

402 Chapter 1 of the UNCITRAL Guide para 73 at 26.

403 M Jansen 'More legal security regarding security by means of general notarial bond' (2003) 15 *SA Merc LJ* 486 at 487.

404 P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 607 (also referred to by R Brits *Real Security Law* (2016) n 1 at 193). See also PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 384. See further, GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 399.

to the underlying transaction.[405] But, other than a pledge, the *erga omnes* enforceability coincides with: (1) registration in the deeds office, in the case of a special notarial bond in terms of the SMPA (creating a non-possessory security device);[406] or (2) registration *and* subsequent delivery in the case of a general notarial bond (essentially a possessory security device).

Two types of notarial bond can be registered over movable property.[407] In section 102 of the Deeds Registries Act,[408] a notarial bond is defined as a bond that has been attested by a notary public, which would then hypothecate movable property either *generally* or *specially*. Accordingly, either a special notarial bond or a general notarial bond can be registered. Different legal consequences attach to the registration of either a special or general notarial bond, which are highlighted *infra* as part of the discussion of the legal nature of each type of notarial bond.

The remaining themes in the discussion on notarial bonds correspond to the structure applied to pledges above. First, the scope of application of notarial bonds with reference to the types of asset and obligation is considered. Thereafter, the method of the simultaneous creation and third-party effect of the limited real right is explained. The discussion of priority rules is brief as the rules are clear and predictable. The discussion of enforcement is likewise brief given the overlap with the enforcement measures for pledges discussed *supra*. The discussion on notarial bonds concludes with an analysis of how effectively notarial bonds operate in a modern commercial context.

2.5.2 Legal nature of notarial bonds

The legal nature of each type of notarial bond depends on whether the common law, legislation, or both apply to that type of notarial bond. The most important statutes which influence the legal nature of notarial bonds are the SMPA and the Deeds Registries Act.

405 P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 607.

406 GF Lubbe 'Mortgage and pledge' (rev TJ Scott) in WA Joubert & JA Faris (eds) *LAWSA* Vol 17 Part 2 (2nd ed 2008) para 402. Registration also results in the exclusion of the landlord's tacit hypothec in respect of goods registered under a special notarial bond in terms of the SMPA.

407 *Land and Agricultural Development Bank of South Africa v Phato Farms (Pty) Ltd* 2015 (3) SA 100 (GP) para 45.

408 47 of 37 (the Deeds Registries Act).

(a) Legal nature of a general notarial bond

In general, the common law applies to the legal consequences of general notarial bonds,[409] while the Deeds Registries Act regulates the registration process. The hypothecated property must be delivered to the bondholder to perfect a registered general notarial bond. Therefore, as with pledges, transfer of possession is the constituting act.[410] An unperfected general notarial bond only provides the bondholder with 'a sense of security',[411] and is, in fact, a personal obligation between the parties,[412] but with the added advantage of affording the creditor priority over other concurrent creditors in respect of the free residue of the insolvent estate of the debtor (or mortgagor). Accordingly, the holder of a general notarial bond does not have a limited real right in the debtor's assets until perfection through delivery has taken place. Perfection takes place when the bondholder is placed in lawful control of the encumbered assets and it results in the dispossession of the debtor. This differs from the position of perfection in terms of a special notarial bond under the SMPA.

(b) Legal nature of a special notarial bond

A special notarial bond does not require the dispossession of the debtor. The SMPA specifies the legal consequences of special notarial bonds which comply with the Act,[413] but the Deeds Registries Act regulates the registration procedure. The special notarial bond must be registered in the deeds registry to have legal effect. For registration to replace 'delivery' as the publicity method, registration must conform to very specific requirements set out in the SMPA. Potentially, a special notarial bond in terms of the SMPA can be either a 'statutory possessory pledge'[414] or a *sui generis* right (as was the case under the Natal Act). The precise legal nature is explored further *infra*.

409 M Jansen 'More legal security regarding security by means of general notarial bond' (2003) 15 *SA Merc LJ* 486 at 487.

410 R Brits *Real Security Law* (2016) at 193.

411 R Brits *Real Security Law* (2016) at 203. The unperfected general notarial bondholder offers none of the advantages available to a secured creditor.

412 *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd* 2003 (2) SA 253 (SCA) para 3.

413 M Jansen 'More legal security regarding security by means of general notarial bond' (2003) 15 *SA Merc LJ* 486 at 487.

414 *Bokomo v Standard Bank van SA Bpk* 1996 (4) SA 450 (C) (the *Bokomo* judgment) at 455C-D where reference is made to a special notarial bond as a 'statutêre pandreg'. It was also referred to as a 'non-possessory pledge' in *Farmsecure Grains (Edms) Bpk v Du Toit* 2013 (1) SA 462 (FB) (the *Farmsecure Grains* judgment).

The concept of a registered special notarial bond which functions as a 'fictitious pledge', originated in the former Natal province of South Africa. This approach was later adopted throughout South Africa under the SMPA when the legislator saw it fit to equate a special notarial bond and a 'deemed pledge'.[415] The pledge is termed 'fictitious' as the object is 'deemed to have been pledged to the mortgagee as effectively' as if the object was pledged and then delivered to the mortgagee.[416] A possible implication of creating a 'fictitious pledge' is that the rules applicable to possessory pledges *potentially* also apply to special notarial bonds unless directly excluded by law. The principal consideration should be that the rules of pledge were developed in the context where physical control of the asset was transferred to the secured creditor.[417] In this light, it makes sense that different rules should apply to a non-possessory security device. For example, there is no 'deemed possession' in the case of special notarial bonds, the bondholder 'is not in fact or in law in possession', and for all practical purposes the debtor (mortgagor) still has the power to deal with the secured property.[418] Essentially, the bondholder holds a device 'less than a pledge constituted by delivery of possession'. In this case, the bondholder is acutely aware of the inherent risk of holding security of this nature.[419] Attempting to impose rules that apply to a pledge to special notarial bonds for all intents and purposes amounts to trying to fit a square peg into a round hole.

The goal of achieving equivalent outcomes does not mean that the legal nature of the instruments is identical. The pledgee (under a pledge) and mortgagee (under the special notarial bond) have the same rights. However, the risks inherent in holding the rights differ due to the possessory or non-possessory nature of the respective security devices. For example, the fact that the pledgee has possession of the pledged object places her in a better practical position than the mortgagee under a special notarial bond.[420] A pledgee with possession also has a duty of care which the bondholder without possession does not.

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415 The preferred alternative would be that a special notarial bond is a *sui generis* real security measure. See R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 261.

416 Section 1(1)(*b*) of the SMPA. There are also certain *quasi*-state institutions that use legislation to 'bypass' the delivery requirement where the creditor is deemed to have a pledge. This include the rights under s 30 of the Land and Agricultural Development Bank Act, and Schedule 1 part 4 item 4 to the Co-operatives Act. However, this extensive legislative protection is provided in order to protect agricultural production.

417 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 257.

418 *Milne NO and Du Preez NO v Diana Shoe and Glove Factory (Pty) Ltd* 1957 (3) SA 16 (W) (the *Milne* judgment) at 20. See also R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 254.

419 *Milne* judgment at 20.

420 See R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 255 where he points out that the risk under the Natal Act was that when

In terms of the Notarial Bonds (Natal) Act,[421] the limited real right amounted to a *sui generis* right. Section 1(1) of the Natal Act stated that 'no notarial bond shall have the *force or effect* of a pledge on movables *without delivery* thereof by the debtor' (emphasis added) if the bond was not registered as this type of bond. The stricter test under the SMPA is due to the inclusion of the words 'deemed to be pledged'.[422] The 'force or effect' is the preferred wording as it conveys that a special notarial bond is equivalent to, but not the same as, a pledge. What follows is a discussion of the modern development of special notarial bonds that originated under the Natal Act.

2.5.3 Modern historical development

(a) Before the SMPA

The South African law relating to special notarial bonds before 1993[423] is correctly described as 'fragmented'.[424] Different legal consequences attached to a special notarial bond registered in Natal[425] and special notarial bonds registered outside of Natal.[426] This difference may be ascribed to the effect of the provisions of the Natal Act on the operation of the then (1916) Insolvency Act.[427] Effectively, a special notarial bond registered in Natal was a non-possessory security right. The rights under a special notarial bond in respect of *corporeal* movable property situated in the province of Natal, which was specifically described and enumerated in a

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the goods were taken outside of Natal, the mortgagee lost her preferential right. The issue of location is no longer a risk under the SMPA.

421 18 of 1932 as amended by Act 57 of 1937 (the Natal Act) which was repealed by the SMPA.

422 See the Lewis JA in the *Ikea* judgment para 22 reaching the conclusion that these words result in the special notarial bond needing to have the same characteristics as a pledge. See also R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 264.

423 This is limited to the modern historical development, post-unification of South Africa. However, see the discussion in JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 120-127 and P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 606-608 (the position outside Natal) on the historical development of notarial bonds.

424 R Brits 'Pledge of movables under the National Credit Act: secured loans, pawn transactions and summary execution clauses' (2013) 25 *SA Merc LJ* 555 at 249. Also see the discussion of the pre-1993 position in R Brits *Real Security Law* (2016) at 231-238.

425 Before the first democratic elections in 1994, South Africa was divided into four provinces: Natal, Transvaal, the Cape Province, and the Province of the Orange Free-State.

426 S Scott 'Notarial bonds and insolvency' (1995) 58 *THRHR* at 673. See also C van der Walt, G Pienaar & C Louw 'Sekerheidstelling deur middel van roerende goed-nog steeds onsekerheid!' (1994) 57 *THRHR* 614 at 620,621 for a brief discussion of the position under the Natal Act.

427 According to JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 129, the creation of the mobile hypothec in Natal was the result of an incorrect interpretation of the *mobilia non habet sequelam* rule in *London and South African Bank v Trustees of the Estate of TP James* 1869 NLR 129 at 133-134 and *Turner Brothers v Colville and Green* 1883 NLR 6.

notarised and registered notarial bond, had the 'force and effect' of a pledge.[428] The holder of this bond acquired a secured right in the event of the debtor's insolvency on two grounds: either as a pledgee, or as the holder of a special notarial bond (registered in Natal).[429] Consequently, the bonded movable property did not form part of the free residue on insolvency and awarded the same right as if it was a special bond hypothecating immovable property.[430] Conversely, *any* notarial bond registered outside of Natal was in effect a pledge agreement, irrespective of the agreement being reduced to writing and also registered. Thus, the preference for the creditor still required perfection through delivery, rendering registration of a special notarial bond outside of Natal pointless.

The Insolvency Act, before it was amended by the SMPA, assigned a preferential right to the holder of a special mortgage. However, the definition of a special mortgage in section 2, only included a special notarial bond *in terms of the Natal Act*. There was no statutory preference for any special notarial bond (even if it was registered) outside of Natal and also no preference over other concurrent creditors in the free residue of the insolvent estate.[431] Conversely, under the then section 102 of the Insolvency Act, any holder of a 'general mortgage bond' had a preferential right to share in the free residue of an insolvent estate ahead of other concurrent creditors. The preference even extended to the free residue resulting from the sale of *all* movables owned by the debtor, not only the encumbered movable property.

The SALC discussion paper recommended that a non-possessory pledge, evidenced in a general pledge register, be introduced, but this suggestion was criticised and not recommended in the final report.[432] The alternative was to extend the draft legislation, similar to the Natal Act, to the whole of South Africa.[433] However, the impression was that this extension would

428 Sections 1(1) and 2 of the Natal Act.

429 P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 610.The author states that the only difference between the rights under these securities is that the special notarial bond has an automatic priority over the landlord's hypothec under provincial legislation. However, the Insolvency Act at that time did not have the same priority and the author correctly concluded that the two security rights ranked *pari passu*.

430 Section 4 of the Natal Act.

431 Joubert AJ correctly summarised the position of a special notarial bondholder in the *Cooper* judgment at 85 (*contra* to *Vrede Koöp Landboumaatskappy Bpk v Uys* 1964 (2) SA 283 (O) at 286D, where the court relied on common law to afford a preference for the special notarial bond holder over other concurrent creditors). Also see P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 and the decisions listed in n 54 at 613 as possible authority of a preference for the special bondholder *only* in that part of the free residue consisting of the proceeds from the sale of those assets specially hypothecated. The free residue relates to the proceeds of those assets in the insolvent estate not subject to any preference as a result of a special bond, pledge, legal hypothec or right of retention (due to operation of law).

432 SALC report at 113.

433 SALC report at 113.

be a temporary measure depending on the number of registrations of notarial bonds that took place.[434] This commercially-viable option is yet to be introduced into South African law.

Before the judgment in *Cooper NO v The Master*,[435] the position was that even though special notarial bonds registered outside of Natal did not result in a secured right, they at least provided the holder with a preference above other concurrent creditors. Whether this was the correct position, depended on whether common law allowed the preference, but more importantly, whether the reference to general mortgage, by implication, included a special notarial bond registered outside of Natal.[436] The *Cooper* judgment rejected this interpretation which effectively resulted in the holder of special notarial bond becoming a regular concurrent creditor for the first time under South African law.[437] This judgment was the turning point that sparked legislative reform in the form of the SMPA and very soon after the judgment was handed down.[438] The facts were as follows.[439] Two creditors, Sentraalwes and Trustbank, both registered notarial bonds over certain of the debtor's movable assets. The debtor's estate was sequestrated, and Cooper was appointed as trustee of the insolvent estate. Sentraalwes had registered a *special* notarial bond in the Bloemfontein deeds registry, thus outside of Natal. Trustbank had registered a *general* notarial bond, also in the Bloemfontein deeds registry. Neither creditor had taken possession of the encumbered assets to perfect its security. The debtor was sequestrated and the trustee proceeded to sell the assets of the insolvent estate. The Master of the High Court approved payment of a minimal amount from the free residue to Sentraalwes, despite its holding a special notarial bond,[440] and this was only *after* a payment had been made to Trustbank, which only held a general notarial bond.[441] Sentraalwes

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434 The SALC report at 113 refers to implementing the measure to have been the most practical solution at that stage. The report refers to a central registry also considering future computerisation (at 115).

435 1992 (3) SA 60 (A) (the *Cooper* judgment).

436 See S Scott '*Cooper NO v Die Meester* 1992 3 SA 60 (A): spesiale notariële verband-preferensie-insolvensie' (1992) 25 *De Jure* 496 at 498, with reference to the sources in the last paragraph, confirming that no such preference existed under common law.

437 S Scott '*Cooper NO v Die Meester* 1992 3 SA 60 (A): spesiale notariële verband-preferensie-insolvensie' (1992) 25 *De Jure* 496 at 497 and 505.

438 The judgment created an opportune moment for reform as the SALC had just finalised its final report on Project 46 in 1991 and the one of the members of the commission was Olivier JA, coincidently also the judge who delivered the judgment in the of the court *a quo* in favour of the decision of the Master to overrule the decision in *Cooper*. See also JC Sonnekus 'The correlation between the requirements for and content of a real agreement and meaningful real security rights in a financial crisis' 2012 *TSAR* 670 at 688 and JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 114 and 115.

439 The facts are summarised in the *Cooper* judgment at 68E-F.

440 R6 540 of the R138 895 of the proceeds from the realised asset over which Sentraalwes registered the notarial bond. The Master considered himself bound to the decision in *Vrede Koöp Landboumaatskappy Bpk v Uys* 1964 (2) SA 283 (O).

441 Trustbank received just over R132 000.

approached the Free State Provincial Division of the High Court, as it then was, to review the decision of the Master.[442] The court *a quo* held that a claim secured by special notarial bond registered in favour of Sentraalwes, is a preferential claim and must share in the free residue of the insolvent estate according to common law. Cooper appealed to the Appellate Division, as it then was, against this decision. Joubert JA provided a comprehensive discussion of current law as well as the historical development of the legal principles applicable to notarial bonds in South Africa.[443] The main bone of contention was whether the reference to a 'general bond' in the pre-amended section 102 of the Insolvency Act, also applied to special notarial bonds *by implication*. According to Joubert JA, the preference list under the Insolvency Act was a closed list with no mention of a preference to be afforded to special notarial bonds registered *outside* Natal.[444] Also, common law did not create a preferential claim in favour of the holder of a special notarial bond registered outside of Natal, unless the movables had been *delivered* to the bondholder. The outcome was that Sentraalwes had no preferential claim and ranked equal to other concurrent creditors of the insolvent estate, but below Trustbank which held the registered general notarial bond. This decision caused huge concern within the credit industry. These concerns resulted in the SMPA being enacted – perhaps too hastily.

(b) Security by Means of Movable Property Act introduced

The SMPA amended section 2 of the Insolvency Act in 1993 and section 3 of the SMPA repealed the Natal Act in its entirety. The reference in section 2 to 'special mortgage' now includes a bond in terms of the SMPA.[445] This means that the bondholder becomes a secured creditor when the debtor goes insolvent[446] in that she holds both a pledge *and* a special mortgage, both security devices listed as securities in section 2 of the Insolvency Act.

The next part of the discussion of notarial bonds addresses the elements of the legal framework applicable to notarial bonds.

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442 The judgment of the court *a quo* was reported as *Cooper NO v Die Meester* 1991(3) SA 158 (O).

443 However, the accuracy of the discussion is questioned by JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 127-128, but it makes no difference to the outcome of the *Cooper* judgment.

444 *Cooper* judgment at 82H-I. Also, see R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 251-252 for a brief synopsis on the outcome of the case and the consequence for practice, resulting in the legislative amendment.

445 The previous reference was to a notarial bond specifically described in the Natal Act.

446 The application now extends to all special notarial bonds registered in South Africa.

2.5.4 Scope of application

2.5.4.1 Assets: special notarial bond

Special notarial bonds, as contemplated in the SMPA, are registered over a very limited class of corporeal movable assets, which must be specified and specifically described in the bond document. Assets such as incorporeal movable property, stock-in-trade (or inventory) and the entire business of the debtor are excluded.[447] The exclusion of incorporeal property should be questioned, especially as it is possible to describe certain incorporeal property with the specificity required by section 1(1) of the SMPA.[448] Unfortunately, the exclusions of assets limits the modern commercial application of this security device to a significant extent. Essentially, the exclusions eliminate categories of asset that are frequently used as security in modern secured transactions, leaving the creditor with either a general notarial bond or a pledge as options for security devices to create a limited real right in the excluded assets. At first blush, this exclusion makes sense in that delivery is a requirement for certain incorporeal objects – eg, bills of lading and other negotiable instruments.[449]

From the discussion on 'specificity' which follows, it emerges that the legislature never intended to include stock-in-trade as an object of a special notarial bond under the SMPA.[450] The focus was rather on assets identifiable with a reasonable measure of certainty using a unique identification standard.[451]

It is also not possible to register a special notarial bond over future assets, in the main because of the application of the accessory principle[452] and the strict specificity principle

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447 The last two examples are excluded due to the revolving nature of this type of asset. See N Locke 'Security granted by a company over its movable property: the floating charge and the general notarial bond' (2008) 41 *CILSA* 136 at 141. Further, in relation to incorporeals, see S Scott 'A comparison between Belgian, Dutch and South African law Dealing with pledge and execution measures' (2010) 43 *CILSA* 1 at 19 and S Scott 'Notarial bonds and insolvency' (1995) 58 *THRHR* at 683 where she states that such exclusion severely reduces the commercial application of this security construct. Incorporeal movable property is regarded as a highly suitable and even sometimes the *only* available collateral a debtor has. See U Drobnig 'Secured credit in international insolvency proceedings' (1998) 33 *Tex Int'l LJ* 53 at 55.

448 C van der Walt, G Pienaar & C Louw 'Sekerheidstelling deur middel van roerende goed-nog steeds onsekerheid!' (1994) 57 *THRHR* 614 at 617.

449 This is also why possession as a form of publicity is still included under the UNCITRAL instruments (see Chapter 3 *infra*) and the regional instruments discussed in Chapter 4 *infra*.

450 JC Sonnekus 'Omskrywing van sekerheidsopbjekte vir die doeleindes van die Wet op Sekerheidstelling deur Middel van Roerende Goed 57 van 1993' (2005) 38 *De Jure* 133 at 135. See also the SALC report at 121 where the inclusion of stock-in-trade was referred to as 'impractical' and left to commerce to determine to what extent stock-in-trade would be 'identifiable and usable' as the object of a special notarial bond.

451 JC Sonnekus 'Omskrywing van sekerheidsopbjekte vir die doeleindes van die Wet op Sekerheidstelling deur Middel van Roerende Goed 57 van 1993' (2005) 38 *De Jure* 133 at 135.

452 N Locke 'Security granted by a company over its movable property: the floating charge and the general notarial bond' (2008) 41 *CILSA* 136 at 142 says it is doubtful whether a special notarial bond can be registered over future property, but it definitely cannot be registered over revolving assets.

discussed below. The real right in the bonded property under a special notarial bond vests in the creditor at the time of registration, which would be impossible if the property – being future property – does not yet exist.[453] It is also difficult to describe a future asset to accord with the specificity requirement where the asset does not exist when the bond is registered.[454] Consequently, a special notarial bond can only be registered over a limited class of assets and this limits its commercial viability.

2.5.4.2 The influence of the specificity principle on the scope of application

The specificity principle fulfils an important role in special notarial bonds. The purpose of the detailed asset description is to give notice to the general public that *specific* movable property is hypothecated under that special notarial bond.[455] This, in turn, avoids the possibility of fraud or any controversy in the case of too general a description, which could defeat the creditor's rights.[456] Therefore, the specificity in the description must be able to comply with the identification function of publicity.[457] But the application of the specificity principle under the SMPA is an area in need of reform – a balance needs to be struck between the extent of transparency required and the need for greater flexibility as regards the asset description.

Where the asset description in a registered special notarial bond fails to comply with the specificity requirement, the notarial bond registered under the label of a special notarial bond will operate as a mere general notarial bond.[458] However, it will not automatically be regarded

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453 The court in the *Bokomo* judgment at 454G-J was incorrect in following the common-law principles of pledge, to find that the where special notarial bondholder becomes owner of the bonded property *after* registration of the bond, this security becomes valid retrospectively. The decision is criticised by JC Sonnekus 'Spesiale notariële verband, beskikkingsbevoegdheid en logiese vooroordeel' 1997 *TSAR* 154 at 154-163, JC Sonnekus 'Saaklike sekerheidsreg vir onsekere toekomstige vordering en sameloop met retensiereg op roerende saak' (1999) 10 *Stell L Rev* 397 at 401; and JC Sonnekus 'Notariële verbande lei na twintig jaar van duidelike wetgewing steeds tot verwarring' 2013 *TSAR* 362 at 364.

454 See N Locke 'Security granted by a company over its movable property: the floating charge and the general notarial bond' (2008) 41 *CILSA* 136 at 142 where the author makes the point that a general notarial bond is similar to floating charge (which can be registered over future things), but not similar to a special notarial bond due to the specificity requirement for special notarial bonds.

455 *Durmalingham v Bruce NO* 1964 (1) SA 807 (D) (the *Durmalingham* judgment) at 812G-H. See also JC Sonnekus 'Omskrywing van sekerheidsopbjekte vir die doeleindes van die Wet op Sekerheidstelling deur Middel van Roerende Goed 57 van 1993' (2005) 38 *De Jure* 133 at 139.

456 *Rosenbach* judgment at 203D.

457 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 262.

458 *VKB Landbou (Edms) Bpk v Du Preez* 2014 JDR 2474 (FB). The court makes no specific mention that due to the fact that the special notarial bond does not comply with the specificity requirement of the SMPA, the bond would amount to a general notarial bond. The court simply continued to refer to the law which would relate to a general notarial bond (paras 14-15). Thus, it is assumed that a special notarial bond which does not comply with the specificity requirement would become a general notarial bond. This assumption is incorrect in my view, as this bond remains a special notarial bond, it is merely not subject to the SMPA.

as a general bond as general hypothecation must be included as an alternative in the bond document itself.[459] Essentially, the failure to comply with the specificity requirement for a special notarial bond, means that the creditor must first perfect its security by taking possession of the property.

The Natal Act also included a specificity requirement, be it a simpler version than that in the SMPA. Under the Natal Act movables had to be 'specially described and enumerated'.[460] The Natal Act only required that the object(s) had to be specifically listed. Including this specificity requirement meant that room for any form of conflict was reduced as 'hypothecated movables [had to] be capable of easy identification' at any given moment.[461] Under the Natal Act, the aim of the specificity requirement was to notify the general public that the assets specifically *listed* were hypothecated by the bond.[462] There were, however, exceptions and the specificity principle can be said to have been relaxed under the Natal Act. These exceptions related to crops,[463] animals, and the products and progeny of animals.[464] Unfortunately, these exceptions did not survive under the SMPA. The reason for not including an exception in respect of crops was that crops are often subject to a statutory pledge.[465] Nevertheless, this statutory pledge (exception) is reserved for use by either the state or a cooperative. The SALC report concluded that progeny 'can be easily described as objects of the bond' and that there was, consequently, no need to include a specific provision.[466] Whether it is possible to include the progeny remains debatable as the progeny has not materialised when the bond is registered so I fail to see how the required degree of specificity regarding the description of the asset which does not yet exist yet is possible without a more general standard for specificity.

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459 A special notarial bond that does not comply with the specificity requirement, does not automatically become a general notarial bond, but remains a special notarial bond under common law.

460 Section 1(1). 'Enumerated' means that it had to be listed. The standard requires the description of goods with 'particularity and in detail' (*Rosenbach* judgment at 204A). The description must be 'that at any given moment they may be identified' (*Rosenbach* judgment at 204H).

461 *Rosenbach* judgment at 204

462 See R Brits *Real Security Law* (2016) at 244 and the reference to the *Durmalingham* judgment at 812, 813.

463 Present and future crops. Also, due to the nature of crops, they cannot be enumerated. Further, in terms of s 5 of the Natal Act it was possible for unharvested crops to be the object of a special notarial bond. The SALC report at 119 rejected this inclusion in the SMPA because such crops usually form the basis for a statutory hypothec. However, another objection relates to the crops becoming part of the immovable property due to accession. Nevertheless, to have such an exception makes commercial sense and is recommended in Chapter 5 paragraph 5.4.2.1(*c*) *infra*.

464 Section 7 of the Natal Act sets out requirements for describing animals as 'to specify the kind, the number and identification marks and the place where they are to be kept' (quoted from *Rosenbach* judgment at 203H).

465 SALC report at 119.

466 SALC report at 119.

The test for specificity under the SMPA is stricter than the test under the Natal Act.[467] However, a stricter test was not the solution as it not only reduced flexibility, but also created doubt as to whether a party indeed met this stricter test. The reason for introducing a stricter test was connected to creating a similar type of security as a pledge. It was felt that the right under a special notarial bond had to be similar to that under a pledge where the pledged object was *physically* delivered.[468]

In terms of section 1(1) of the SMPA, the object must be '*specified* and *described in the bond* in a manner which renders it *readily recognisable*' (emphasis added). The essence of this requirement is 'that only it and not other property of like kind' must be identifiable as the hypothecated object by any person who reads *only* the notarial bond document.[469]

The bonded item is 'readily recognisable' when there is complete certainty in identifying the items listed in a special notarial bond without recourse to extrinsic evidence.[470] The notion that identification takes place without recourse to extrinsic evidence is affirmed by the inclusion of 'described in the bond' in the specificity requirement. In other words, a third party who reads *only* the bond document should be able to establish the identity of the bonded property. Accordingly, a notarial bond which refers to a specific asset as 'more fully described in an asset register' held by the debtor, does not comply with the specificity requirement.

This notwithstanding, where a copy of an asset register is annexed to the notarial bond, and that asset register uses a unique mark or characteristic to identify the asset (a *traditio symbolica*), it is theoretically possible that this asset description complies with the wording of the specificity requirement[471] – but according to me not with the purpose behind adopting the

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467 See R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 262 and JC Sonnekus 'Omskrywing van sekerheidsopbjekte vir die doeleindes van die Wet op Sekerheidstelling deur Middel van Roerende Goed 57 van 1993' (2005) 38 *De Jure* 133 at 135. Both authors comment on the *dictum* by Lewis JA in the *Ikea Trading* judgment para 19. According to Lewis JA, the stricter test is evidenced by the introduction of 'readily recognisable', and instead of using the Natal Act phrase 'specially enumerated, including the words 'specified and described'. The reference Lewis JA makes to the meaning of 'specify', 'describe' and 'recognisable' in para 20 also reflects that the test is stricter than under the Natal Act. However, under the Natal Act, the words 'deemed to be pledge' were not included which may explain the stricter test under the SMPA.

468 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 263 and 264 and the *Ikea Trading* judgment para 22.

469 *Ikea Trading* judgment para 24. For example, a notarial bond referring to forty five dairy cows is not an adequate description if there is no other identifying mark or distinctive feature distinguishing these cows from other cows not forming part of that herd (*Standard Bank of SA Ltd v GH Loubser Boerdery CC* 2012 JDR 2205 (FB) para 26 referring to the standard of identification in the *Ikea Trading* judgment).

470 In the *Ikea Trading* judgment paras 11-13, Lewis JA refers to 'reality on the ground', where any third party should be able to take the bond document and identify the hypothecated property with reference to the bond document alone.

471 See JC Sonnekus 'Omskrywing van sekerheidsopbjekte vir die doeleindes van die Wet op Sekerheidstelling deur Middel van Roerende Goed 57 van 1993' (2005) 38 *De Jure* 133 at 137 and the

specificity requirement in this strict form. The important qualification is that the description in the bond must ensure that the asset is 'recognisable' from that description alone. The identification could be achieved by including a description of a unique mark or characteristic used to identify a specific asset.[472] Using a unique mark or characteristic implies some uncertainty. Firstly, the debtor fixes the identifying mark, opening the possibility of fraud.[473] Secondly, where the item is identified by a mark or characteristic, the asset may be replaced by another provided that the new asset has the identifying mark or characteristic. There is, however, no certainty that the new asset is indeed an adequate replacement for the original encumbered asset.[474] Consequently, using the *traditio symbolica* is perhaps taking the interpretation of the meaning of this section a step too far.

The need to have a detailed description of the hypothecated object in the bond itself limits the available methods allowed for identification.[475] Accordingly, the South African law governing asset description and identification methods is underdeveloped, and Chapter 5 will recommend preferred alternatives.[476]

2.5.4.3 Assets: general notarial bond

The general notarial bond is registered in respect of *all* the debtor's movable assets (both corporeal and incorporeal)[477] and includes both her current and future assets.[478] The accessorial relationship between the principal debt and the real right is unproblematic in the case of a

reference to the *Ikea Trading* judgment para 24. Sonnekus's conclusion is supported by R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 266, but the author cautions that there is a risk that the courts may reject this 'innovative method of identification Sonnekus suggests' (Brits at 267).

472 JC Sonnekus 'Omskrywing van sekerheidsopbjekte vir die doeleindes van die Wet op Sekerheidstelling deur Middel van Roerende Goed 57 van 1993' (2005) 38 *De Jure* 133 at 138.

473 It is up to the debtor to identify on which asset she wishes to place the identifying mark, or the debtor can even remove the identifying mark, thus misleading third parties.

474 The replacement asset may be valued at less than the asset initially agreed to between the parties.

475 N De La Peña ' Reforming the legal framework for security interests in mobile property' (1992) 2 *Unif L Rev* 347-360 at 349. Recommendation 14 of the UNCITRAL Guide requires that the asset must be 'described to reasonably allow identification of the asset'. This requirement is not as strict as that under the SMPA and Chapter 5 paragraph 5.4.2.2 *infra* recommends a similar standard for South Africa.

476 See R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 272 and R Brits *Real Security Law* (2016) at 245. See also Chapter 5 paragraph 5.4.2.1(*b*) *infra* for the recommended standard by which to describe the encumbered asset and secured obligation.

477 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) fn 219 at 385. See also, the sources in R Brits *Real Security Law* (2016) n 37 at 199.

478 A general bond registered only over the current and not future assets is regarded as a poorly-drafted special notarial bond that is not subject to the SMPA as it singles out assets which only existed when the bond was registered. See R Brits *Real Security Law* (2016) at 200.

general notarial bond as the real right only comes into existence at the moment that the future asset comes into existence and the bondholder is able to take actual control over it. Consequently, nothing prevents the debtor from selling the bonded property before perfection, save for a *contractual* prohibition against disposition. Thus, a general notarial bond can loosely be termed a 'floating security device', where the debtor is able to deal with her assets until perfection has occurred, unless contractually prohibited from doing so.

Where the bond excludes specific assets in the description, the bond strictly speaking qualifies as a special notarial bond, either under the SMPA or under common law, depending on the extent of compliance with the specificity requirement in the SMPA. Although it is possible to take a pledge over an economic entity,[479] this does not appear to be possible under a general notarial bond, as describing the asset as an economic entity singles out a group of assets (the economic entity), which would make this a special notarial bond. Accordingly, it would not be possible to register the general notarial bond only over the debtor's stock-in-trade (an example of an economic entity), while excluding the debtor's other assets. Also, there are practical concerns to bond stock-in-trade under a notarial bond. In respect of stock-in-trade, the stock changes continuously until the security is perfected, potentially reducing the value of the security when perfection eventually takes place. Possibly, this practical dilemma may be mitigated by agreeing contractually to prohibit the replacement of the stock until perfection, or in the alternative, allowing that value of the stock to be maintained at an agreed level.

In practice, a creditor would usually register a special notarial bond over specifically described assets, but also register a general notarial bond for a dual purpose. First, the general bond would serve as a 'catch-all security' if any movable property was omitted from the description in the special notarial bond, or not described in a way that meets the specificity requirement. Second, where the value of the assets capable of being specifically described, proves insufficient to secure the principal obligation, additional security is provided by also holding a general notarial bond.

The vague and general nature of the general notarial bond does not satisfy the specificity principle and it appears that registration in its current form cannot establish a secured right equivalent to the right under the special notarial bond in terms of the SMPA.[480] This approach does, however, allow greater flexibility for the parties, especially where the bonded assets are

479 For example, a flock of sheep referred to in the pledge discussion.

480 JC Sonnekus 'Borgverbande oftewel algemene notariele verbande en borgstelling: *Van der Walt v Le Roux* [2004] 4 All SA 476 (O)' 2005 *TSAR* 609 at 616.

classified as 'revolving'.[481] The main consideration appears to be to what extent there must be a trade-off between the required level of transparency and the flexibility of the framework.[482] The ideal outcome would be to have an asset description that is sufficiently certain.

It is theoretically possible to take a general notarial bond over an entire business. Some authors distinguish between a 'common general notarial bond' and a 'business bond'.[483] But, according to Brits, this distinction has no practical value.[484] Until the general notarial bond has been perfected, the creditor has no more than a personal right against the debtor. Effectively, the debtor can deal with her property as she pleases,[485] subject, of course, to the provisions of the contract. However, the contractual provision requiring the registration of a general notarial bond over an entire business may be unreasonable and regarded as inflicting undue hardship on the debtor. But, according to the Supreme Court of Appeal in *Juglal NO v Shoprite Checkers (Pty) Ltd t/a OK Franchise Division*,[486] provisions which extend security over an entire business are neither oppressive nor *contra bonos mores*. A general notarial bond may be registered to secure the obligations imposed on a franchisee in terms of a franchise agreement. Where the bond contains a perfection clause, arguably when the franchisee defaults under the franchise agreement, the franchisor (the bondholder) may take over the franchise (the business). The business will continue to operate as a going concern, to allow the franchisor to find a suitable replacement for the current franchisee.[487]

2.5.4.4 Extension of the real right to proceeds, a mass, or a product

As with the position under the Natal Act, it remained possible for the bondholder under the SMPA to trace the proceeds from the hypothecated goods. 'Tracing' is subject to those proceeds remaining identifiable. However, in the context of special notarial bonds, the meaning

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481 JC Sonnekus 'Onverwagte raakpunte tussen menseregte en saaklike sekerheidsregte?' 2002 *Tijdschrift voor Privaatrecht* 1 at 3.

482 Chapter 5 at paragraph 5.2.1.4 *infra* I discuss this trade-off and its effect on the certainty of a legal framework.

483 The idea behind a business bond is to make it possible for the debtor to sell and acquire stock-in-trade and other assets as part of the ordinary course of business. See P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 608 and 616-619.

484 R Brits *Real Security Law* (2016) at 200, 201.

485 R Brits *Real Security Law* (2016) at 201.

486 2004 (5) SA 248 (SCA) (the *Juglal* judgment) paras 26-27.

487 *Juglal* judgment paras 23-24. This decision was also followed in *Pick n Pay Retailers (Pty) Ltd v Pine Valley Supermarket (Pty) Ltd* (8209/2014) [2015] ZAKZDHC 27 (20 March 2015) para 36 http://www.saflii.org/za/cases/ZAKZDHC/2015/27.html (the *Pick n Pay Retailers (Pty) Ltd* judgment) (date of access: 7 October 2019).

of 'proceeds' is not as wide as under other legal frameworks,[488] and the real security right cannot extend to a new product or mass.[489] On must therefore consider whether the limited real right under a special notarial bond continues to exist when either accession, specification (or *specificatio*), commixtion (or *commixtio*), or confusion (or *confusio*) takes place. Each instance is discussed briefly below.

(a) Accession

Accession[490] entails that movable property is attached to other movable or immovable property. Ownership is acquired through accession where the accessory becomes such an integral part of the thing it is attached to (the principal thing) that the objects are joined in the legal sense.[491] This entails that the objects are joined; that they are, objectively speaking, 'attached'. It is a question of fact whether two things are joined in the legal sense.

The Roman maxims *superficies sole cedit* and *omne quod inaedificatio solo cedit* boil down to everything that is built or attached to immovable property becomes part of the immovable property. However, it is today often disputed whether an attached movable property should be regarded as a fixture. The different factors considered in deciding whether the movable property has become a fixture, include: (1) nature and purpose of the movable property; (2) manner and degree of attachment; and (3) the intention at the time of attachment – the element carrying the most weight under South African law.[492]

The question is whether the subjective or objective intention is the determining factor and whether it is the intention that the fixture should be permanently fixed. There are two approaches: (1) the traditional approach where the intention is inferred by looking at the

488 The UNCITRAL Guide and UNCITRAL Model Law include an extended definition of what is regarded as 'proceeds' (see Chapter 3 paragraph 3.3.3.4 *infra*). The OAS Model Inter-American Law on Secured Transactions refers to 'attributed movable property' (see Chapter 4 paragraph 4.4.4.2 *infra*).

489 Conversely, the security right potentially extends into a mass or a product under the UNCITRAL Guide and Model Law (see Chapter 3 paragraph 3.3.3.4 *infra*) and the OAS Model Inter-American Law on Secured Transactions (see Chapter 4 paragraph 4.3.3.2 *infra*).

490 The sub-category of industrial accession is most likely to be present in case of a movable property bonded under a special notarial bond. Industrial accession denotes the conversion of two distinct things, mostly in case of *inaedificatio* (permanent fixture to immovable property) or *plantatio et satio* (initial artificial act takes place by planting and sowing). See PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 145.

491 R Sharrock *Business Transactions Law* (9th ed 2017) at 919.

492 DL Carey Miller & A Pope 'Acquisition of ownership' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 679.

physical circumstances (objective determination); or (2) the actual intention of the parties, more specifically the owner of the movable property (subjective determination).[493]

The attached movable property is generally reclassified as immovable property as soon as it is attached to the immovable property (being the principal thing). However, immovable property cannot be hypothecated by a notarial bond.[494] Consequently, movable assets hypothecated under a special notarial bond which are subsequently attached to immovable property will no longer be a movable asset and can no longer be subject to the special notarial bond.[495]

(b) Specification

Specificatio entails the 'working up of a thing', ultimately forming a *nova species*, not capable of being restored to the original form of the product from which the new product is manufactured.[496] Specification takes place without the permission of the owner of the raw materials.[497] The general rule in the case of *specificatio*, is that the person who used labour to create a new product, becomes the new owner.[498] It is not settled whether the manufacturer only becomes the owner where there was a *bona fide* belief that the materials used in the manufacture belonged to her.[499] The question of *bona fides* may potentially only be relevant in determining the compensation due to the owner of the raw materials.

493 DL Carey Miller & A Pope 'Acquisition of ownership' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 680.

494 HS Nel *Jones' Conveyancing in South Africa* (4th ed 1990) at 469.

495 Planted crops are a good example under the SMPA of something that cannot be the object of a special notarial bond. See JC Sonnekus 'Notariële verbande lei na twintig jaar van duidelike wetgewing steeds tot verwarring' 2013 *TSAR* 362 at 367, discussing a provision to this effect included in the bond document in the matter of *Farmsecure Grains* judgment.

496 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 156 and the source at fn 203. See also R Sharrock *Business Transactions Law* (9th ed 2017) at 920.

497 DL Carey Miller & A Pope 'Acquisition of ownership' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 682.

498 PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 157. This is the position in both South Africa and Scotland. See DL Carey Miller & A Pope 'Acquisition of ownership' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 682).

499 This appears to be the general position. See PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 159 and the sources in fns 228-230. However, the authors disagree as accepting this principle allows action against the previous owner for compensation. See also DL Carey Miller & A Pope 'Acquisition of ownership' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 683, especially the division in opinion among some modern authors listed in n 73.

Our courts must still clarify the position regarding conflicting interests in the *nova species*.[500] The current position appears to be that it must first be determined whether the requirements for *specificatio* have been met with the outcome depending on the facts of each case. However, as it is a completely new asset with a new owner, the logical conclusion is that the limited real right is extinguished by *specificatio.* Accordingly, the notarial bond extends to the *nova species* only where the mortgagor or a person acting on her authority, caused the transformation of the bonded property.[501] Where it is possible to dismantle the *nova species* into its identifiable components, the real right might continue to exist in the *nova species.*[502]

(c) Confusio and commixtio

Under both *commixtio* (relating to solids)[503] and *confusio* (relating to liquids),[504] joint ownership (or co-ownership, or ownership in common) in a *new* product is established. In case of *confusio* the owners of the original liquids will become undivided co-owners in the newly mixed liquid.[505] In respect of *commixtio* the owners of the original solids obtain ownership of a portion (share) of the newly formed movable property.[506] In respect of *confusio*, there will be a change in ownership to a proportionate undivided co-ownership in the mixed liquid.[507] A limited real right burdens the property, not the right of ownership in the property. Where the original movable property no longer exists, the limited real right in the original property also no longer exists. A co-owner can also not grant a limited real right in a thing without the consent of the other co-owners.[508]

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500 These interests include those of the previous owner, the creditor of the previous owner, and the manufacturer.

501 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 135.

502 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* (3rd ed 1987) at 135.

503 This entails the mingling or amalgamation of solids, where separation is no longer possible (the solids becomes indeterminable). An example is grain received from different farmers, mixed in a grain silo for storage. See PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 159.

504 This entails the mingling of liquids that belong to different people, and in which in most cases can no longer be separated (the liquids become inseparable) and the mixture is jointly owned by the original owners. See PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 159.

505 R Sharrock *Business Transactions Law* (9th ed 2017) at 920. The Scottish position is that co-ownership is established in respect of both *confusio* and *commixtio.* See DL Carey Miller & A Pope 'Acquisition of ownership' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 685.

506 R Sharrock *Business Transactions Law* (9th ed 2017) at 919.

507 DL Carey Miller & A Pope 'Acquisition of ownership' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 685.

508 D Kleyn & S Wortley 'Co-ownership' in R Zimmermann *et al* (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) at 722.

From the above, it is clear that the limited real right under a special notarial bond does not survive accession, *specificatio*, *commixtio*, or *confusio* where the original hypothecated property is no longer identifiable. Furthermore, certain aspects of the legal nature of special notarial bonds make accession, *specificatio*, *commixtio*, or *confusio* impossible. First, a special notarial bond cannot be registered in respect of future assets, which the newly formed mass or product essentially is. Further, it is well neigh impossible to define the newly formed mass or product with the degree of detail required under the specificity requirement at the point at which the bond is registered.

The bondholder needs to use either contractual remedies or unjustified enrichment to claim the outstanding debt from the debtor. In all likelihood, most loan agreements will include a prohibition on *specificatio*, *confusio*, *commixtio*, and accession – or at the very least arrangements on compensation for the bondholder when this takes place. It is also possible for the secured creditor to take out insurance against loss associated with *specificatio*, *confusio*, *commixtio*, and accession of the bonded property.

2.5.5 Creation and third-party effectiveness take place simultaneously

As in the case of pledge (discussed *supra*), there must be a loan agreement (setting out the principal obligation), a real agreement (representing the parties' intention to create a security right and which is contained in the registered notarial bond),[509] and an external action which gives effect to the intention in the real agreement to establish a notarial bond. Moreover, specific provisions of the Deeds Registries Act and the SMPA, also influence whether a real right under the bond is created and when that right will be effective against third parties.

In terms of the Deeds Registries Act, a notarial bond is executed before a notary public and then registered by a conveyancer (an attorney who holds an additional qualification) in the deeds registries in the areas where the debtor resides and operates her business.[510] Accordingly, the bond may need to be registered in multiple registries. The first registration must be done within three months after the attestation by a notary. For subsequent registrations, an additional month is added to the initial three months.[511] The notarial bond will only be effective against third parties from the date of the *first* registration. A lack of registration leaves both the creditor

509 Section 61 of the Deeds Registries Act prescribes the information to be included in a notarial deed registered in the deeds office.
510 Sections 61, 62 and 102 of the Deeds Registries Act.
511 HS Nel *Jones' Conveyancing in South Africa* (4th ed 1990) at 470.

and third parties exposed to potential risks during this three-month period – ie, the period between notarial execution and registration.[512] A notarial bond not registered within this three-month period will be invalid and of no force or effect.[513] The potential delay in third-party effectiveness illustrates how an expedited filing system could reduce this risk associated with the registration of a notarial bond.

Creation and third-party effectiveness in the case of special notarial bonds which comply with the SMPA take place simultaneously when the notarial bond is registered in the deeds registry. However, for general notarial bonds and special notarial bonds which do not comply with the SMPA, registration alone does not result in the perfection of the security – the bondholder must also take possession of the hypothecated property to perfect its security.[514] The *registered* general notarial bond is, however, valid against unsecured creditors.[515] Why a bondholder would elect to go to all the effort of registering a general notarial bond when possession must still take place before she has a secured claim, is unclear. The one benefit is that if the debtor is insolvent, a general notarial bondholder is ranked above the claims of other concurrent creditors, even where the security under the bond has not yet been perfected. Therefore, where the general notarial bondholder does not retain possession, her secured position is lost,[516] although she probably retains her preferential status above other concurrent secured creditors.[517]

In summary: (1) the creation and third-party effectiveness of notarial bonds occur simultaneously; and (2) the process of creating the real right requires cumbersome and costly procedures in the form of notarisation and deeds office registration in case of special notarial bonds, and notarisation, deeds office registration, and delivery in case of general notarial bonds.

2.5.6 Publicity takes place in a registry that forms part of a land register

512 See P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 631. See also, the SALC report at 115 recommended that the registration period be reduced.

513 R Brits *Real Security Law* (2016) at 195.

514 See J Roos 'The perfecting of securities held under a general notarial bond' (1995) 112 *SALJ* 169 at 169 and the discussion of the background to how general notarial bonds are perfected.

515 This is similar to the position under UCC Article 9 where 'attachment' takes place before perfection and the security interest is valid *inter partes* and against unsecured creditors.

516 This is where the position under the EBRD Model Law between the chargor of a possessory pledge differs in that the secured position is not lost when possession is lost. See Chapter 4 paragraph 4.4.3.2(*e*) *infra*.

517 According to R Brits *Real Security Law* (2016) at 227, in accordance with the *mobilia* maxim, the bondholder will lose her rights as pledgee, but retain the rights as a notarial bondholder.

In the case of notarial bonds (both general and special), the full bond document must be registered in the deeds registry. The deeds registry functions primarily as a register for immovable property. A land registry system is notoriously 'slow, rigid and expensive' and operates on the basis of ownership registration.[518] Although using a land registry is not ideal, at the time when the SMPA was implemented, using the existing land registry was the most cost-effective option.[519] This was also the registry used to register notarial bonds under the Natal Act. However, it is no longer regarded as 'affordable' relief.[520] Surely, after almost three decades, South Africa should have come up with a more cost-effective and accessible alternative to the current registration regime?

The section of the registry dealing with notarial bonds is debtor-based.[521] This means that the registry is searched via the debtor's identity and not the hypothecated movable property. Furthermore, creditors would need to visit the deeds office to inspect a copy of the notarial deed on microfilm or order a hard copy from the registry.

The registration of a notarial bond is an example of 'transaction-filing' – albeit with notary involvement. The registration process is largely manual and takes in excess of a business week to complete.[522] The notarial bond document is examined by the same examiners who are responsible for examining registration documents for immovable property. Further, after registration, information regarding the bond is captured manually and so the registration takes time to reflect on the public system. Usually, the document is examined by three levels of examiner before the documents come up for preparation.[523] The date of registration is when the Registrar of Deeds affixes her signature to the bond document in the presence of the conveyancer responsible for the registration of the notarial bond. This differs from a notice-

518 HC Sigman 'Perfection and priority of security rights' (2008) 5 *ECFR* 143 at 156.

519 JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 137 correctly refers to the success of the privately-administered central computer systems of the credit bureaus. See this as a recommendation made in Chapter 5 paragraph 5.4.4.2 *infra*.

520 JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 137 refers to 'bekostigbare verligting' (affordable relief). However, time has shown the registration of special notarial bonds not to be overly affordable.

521 The international instruments (discussed in Chapter 3 paragraph 3.3.3.6 *infra*) and the regional instruments (discussed in Chapter 4 paragraphs 4.2.3.2(*e*) and 4.3.3.4 *infra*) all recommend a debtor-based filing system.

522 However, this may change soon. The Electronic Deeds Registration System Act 19 of 2019 was signed into law and will become effective on the date to be proclaimed (see *GG* 42744 of 3 October 2019). The purpose of the new system is to allow the electronic processing, preparation and lodgement of documents with the Registrar of Deeds.

523 The stage the conveyancer needs to check that all the notes from the examiners were addressed and that all is in order to register the bond within the next few days.

filing system where the security right is as a rule enforceable as soon as it becomes 'searchable' in the registry.

Even before the registration of any notarial bond, a potential creditor will have to conduct and pay for a search to determine if there is a notarial bond registered over the debtor's movable property. Before the registration process commences, the notarial bond must be notarised. However, as Garro points out, 'notarial acts are patently out of place' when dealing with secured transactions, as this increases the transactional costs.[524] Furthermore, the thorough process to which the registration of notarial bonds is subjected corresponds to the registration of a right in immovable property – a right which must to exist for much longer than the right under a notarial bond used to secure short and medium finance. Consequently, the registration process for notarial bonds needs to be simplified.[525]

The cost of registering a notarial bond could run to thousands of South African Rands.[526] The 2018 'Conveyancing Fees Guidelines', including prescribed fees for notarial bonds,[527] was released by the relevant provincial law societies (when they still existed).[528] There is a base fee of either R1 120 for notarial bonds securing amounts up to and including R100 000 and R1 700 for bonds securing an amount above R100 000. To this base fee, another fee must be added. The additional fee is calculated using the sliding scale in the table below.

Column A	**Column B**
Value of movable property or the bond amount	**Recommended Guideline of Fees**
R100 000 or less	R4 800
Over R100 000 up to and including R500 000	R4800 plus R735 per R50 000 or part thereof above that
Over R500 000 up to and including R1 000 000	R10 680 for the first R500 000 plus R1470 per R100 000 or part thereof above that
Over R1 000 000 up to and including R5 000 000	R18 030 for the first R1 000 000 plus R735 per R100 000 or part thereof above that

524 AM Garro 'The OAS-sponsored Model Law on Secured Transactions: gestation and implementation' (2010) 15 *Unif L Rev* 391 at 403.

525 Chapter 5 paragraph 5.4.4.2 *infra* recommends adopting a registry with an exclusive focus on movable property.

526 See R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 247 where the high cost of registration is put forward as a potential reason why this security device is underutilised.

527 The deeds office fees were amended in April 2019 but the new conveyancing fee guidelines for 2019 were not available when this study was submitted.

528 For example, see the link to the document on the website of the Cape Law Society at http://capelawsoc.law.za/wp-content/uploads/2018/05/Conveyancing-Fee-Guidelines-Effective-01June2018.pdf (date of access: 10 September 2018).

Over R5 000 000	R47 430 for the first R5 000 000 plus R370 per R100 000 or part thereof above that

Table 2.1: Extract from the Law Society of South Africa: Conveyancing Fees Guidelines (2018)

From this table, it is clear that registering a notarial bond involves considerable cost. For example, for any debt amount of R100 000 or less, the minimum cost for registering a bond is R5 920.[529] The debtor must pay the registration cost, and usually, the cost is added to the principal amount, resulting in the debtor also paying interest on the bond registration costs.[530] Ultimately the true purpose and manner of registration need to be examined to determine their commercial relevance. Registration also has a direct impact on priority to which we now turn.

2.5.7 Priority: clear and predictable rules

The ground rule *prior tempore potior iure* also applies to the priority ranking of notarial bonds. The foundation of an effective priority regime is the publicity principle.[531] Accordingly, the priority ranking depends on the date of registration in the case of a special notarial bond. However, as the general notarial bond is only perfected when delivery of the collateral to the creditor takes place, the date of transfer of possession determines the priority ranking under a general notarial bond. In the case of a notarial bond which is also a covering bond, the date of registration determines the priority ranking.[532]

In terms of the SMPA, a special notarial bond is registered 'subject to any encumbrance' that rests on the bonded property at the date of registration.[533] For example, where the movable property is subject to a perfected possessory pledge on the date the special notarial bond is registered, the pledge will rank above the special notarial bond.[534] Further, in terms of section 5 of the SMPA, specific security held by state and other institutions enjoys preferential treatment above security under a special notarial bond in terms of the Act. This section provides that the provisions of the SMPA will have no effect on 'any mortgage, hypothecation, pledge,

529 To provide some comparative context, to register a pledge in the Belgian National Pledge Register, the amounts include EUR 20 (secured amount below 10 000 EUR) and EUR 500 (secured amount above 500 000 EUR). See https://www.studio-legale.be/1-januari-2018-nieuwe-pandwet-treedt-in-werking/?lang =en (date of access: 6 August 2019).

530 The debtor always has the choice of paying this amount in cash, but this is not always possible for all debtors.

531 JC Sonnekus 'Die notariële verband, 'n bekostigbare figuur teen heimlike sekerheidstelling vir 'n nuwe Suid-Afrika?' 1993 *TSAR* 110 at 111.

532 See paragraph 2.3.3.3(*a*) *supra* for a discussion of covering bonds.

533 Section 1(1)(*a*) of the SMPA.

534 R Brits *Real Security Law* (2016) at 258.

tacit hypothec, preference, lien or right of retention' which was acquired in accordance with any law, either by the state or by a specific type of body corporate or association of people. This includes a body corporate or association established or constituted under any law and which is supported in part or entirely by public funds. The implication of section 5 is that regardless of whether the special notarial bond in terms of the SMPA was registered before any of these rights, it ranks below these statutory rights.[535]

The priority ranking of expressly created, limited real rights depends on when the right becomes effective against third parties unless there is a specific exception to the general rule. Accordingly, determining the priority ranking between a pledge, a general notarial bond, and a special notarial bond in terms of the SMPA, depends on when the respective security device acquired third-party effectiveness. Where a special notarial is registered in respect of movable property where a pledge was perfected in the property before registration of the notarial bond, the pledgee ranks above the special notarial bondholder. The bondholder potentially also competes with the holder of a tacitly limited real right – eg, the landlord's tacit hypothec. The SMPA places the bondholder in a more favourable position than the landlord. The bondholder's claim not only ranks above the landlord's, but the landlord is also not able to share in any proceeds resulting from the sale of the bonded property.[536] This is a change from the position under the Natal Act where the special notarial bondholder ranked below the landlord's hypothec. This suggests that the nature of the legal right under this special notarial bond has moved closer to a pledge than it was under the Natal Act.[537]

Priority also influences how effective the outcome of enforcement measures will be for the secured creditor. Enforcement proceedings in respect of notarial bonds are discussed *infra*.

2.5.8 Enforcement measures in respect of notarial bonds

In many respects, the enforcement measures applicable to pledges also apply to notarial bonds. Accordingly, the discussion *infra* complements the previous paragraph dealing with enforcement measures in respect of pledges.[538] The distinction between the positions of the

535 R Brits *Real Security Law* (2016) at 258.
536 R Brits *Real Security Law* (2016) at 257.
537 C van der Walt, G Pienaar & C Louw 'Sekerheidstelling deur middel van roerende goed-nog steeds onsekerheid!' (1994) 57 *THRHR* 614 at 619.
538 See paragraph 2.4.5 *supra*.

creditor in the case of a solvent versus an insolvent debtor is analysed in the context of notarial bonds.

2.5.8.1 Perfection clauses in notarial bonds

Including a perfection clause in a general notarial bond is of both practical and legal relevance. Conversely, even though nothing prevents the bondholder from including a perfection clause as part of a special notarial bond under the SMPA, it serves no legal purpose as the security will already have been perfected by registration.[539] Consequently, a perfection clause in a special notarial bond over corporeal property provides the bondholder with a *contractual* entitlement to take possession of the movables: (1) when a default event as mentioned in the contract, has taken place;[540] or (2) where another reason which requires immediate possession – eg, to protect the value of the property, or to prevent the debtor from damaging or hiding it – presents itself.[541] However, the perfection of a special notarial bond is relevant where: (1) the bonded property is *incorporeal* movable property (as the perfection does not happen with registration);[542] or (2) where the parties mistakenly thought that the SMPA applied to the registered special notarial bond.[543] In both these instances, the bondholder obtains a right similar to a pledge only when the bondholder obtains control by attaching the bonded object. These instances are, however, subject to this type of special notarial bond containing an enforceable perfection clause.[544]

The security held in terms of a general notarial bond is perfected as soon as the creditor takes possession of the bonded property. Consequently, a perfection clause serves a purpose when it is included as part of a general notarial bond. Perfection clauses are associated with the ability of a holder of a general notarial bond to take possession of the hypothecated property to perfect her security. Until the general notarial bondholder obtains lawful control over the hypothecated movable property, she has only a personal right against the debtor. From when

539 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 271.
540 *Farmsecure Grains* judgment para 35.
541 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 271.
542 This is as special notarial bonds are regulated by common law not the SMPA.
543 For example, where the asset description does not comply with the specificity requirement.
544 S Scott 'Notarial bonds and insolvency' (1995) 58 *THRHR* at 681-682 and R Brits *Real Security Law* (2016) at 262.

the bondholder gains control, she has a limited real right in the movables[545] and becomes a secured creditor.[546] The contractual provision – the perfection clause – which entitles the general notarial bondholder to take possession of the assets, amounts to an agreement to constitute a pledge.[547] Accordingly, the judicial process required to enforce this contractual provision is not repeated, and the discussion under pledges above will suffice.[548] However, other than a pledgee, if a bondholder loses control over the bonded property the pledge is lost, but the rights as a notarial bondholder persist.[549]

2.5.8.3 Position where the debtor is still solvent (including subsequent possessors)

The distinction between the rights of the general and special notarial bondholder in respect of a solvent debtor arises from the difference in the legal nature of the different bonds. Even though both notarial bonds are registered, the general notarial bondholder has only a personal right against a solvent debtor, whereas the special notarial bondholder has a limited real right if the bond complies with the SMPA.

Both bondholders can use an interdict to prevent the solvent debtor from alienating the hypothecated assets. But where the debtor has already disposed of the assets, it must be established whether the respective bondholders can follow or 'trace' the hypothecated movable property into the hands of a third party. This right is dependent on whether the *mobilia non habent sequelam ex causa hypothecae* maxim applies to either or both types of notarial bond.

A general notarial bondholder has only a personal right against the debtor until the bond has been perfected by possession. As a result, the mortgagor can dispose of the mortgaged property to a *bona fide* third party free of encumbrances. Not only will the bondholder not be able to stop the execution, she can also not share in the proceeds of the sale.[550] Accordingly, the *actio in personam* can be instituted against a defaulting debtor when a contractual obligation is breached. Also, the general notarial bondholder cannot follow the property into the hands of a *bona fide* third party: (1) where that party had no knowledge of the bond; and

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545 *Firstrand Bank Ltd v the Land & Agricultural Development Bank* 2015 (1) SA 38 (SCA) para 4. Also see M Jansen 'More legal security regarding security by means of general notarial bond' (2003) 15 *SA Merc LJ* 486 at 489 and M Jansen 'Security by means of general notarial bond' (2003) 11 *JBL* 154 at 155.

546 This is in terms of s 83 of the Insolvency Act. It can only be taken lawfully if possession was taken subsequent to the enforcement of a perfection clause after a court order for specific performance.

547 *Boland Bank v Vermeulen* judgment at 244E-F.

548 See paragraph 2.4.5.3 *supra*.

549 R Brits *Real Security Law* (2016) at 227.

550 R Sharrock *Business Transactions Law* (9th ed 2017) at 799. This is similar to the position of a pledgee also not being able to share in the proceeds.

(2) the third party gave consideration for the property.[551] However, the general bondholder may be able to follow the property into the hands of a third party if the doctrine of notice applies.[552] To be able to follow the property, the third-party acquirer should have *actual* knowledge of a contractual provision in the loan agreement between the bondholder and her secured creditor which prohibits the transfer of the encumbered property to a third party.[553] The fact that the general notarial bond is registered has no bearing on whether or not the general notarial bondholder is able to follow the object into the hands of a third-party acquirer.

The holder of a special notarial bond under the SMPA can follow the hypothecated property into the hands of third-party acquirers. As mentioned above, the maxim *mobilia non habent sequelam ex causa hypothecae* is linked to a person having *physical* control over the hypothecated object and giving up this control. The special notarial bondholder attains a limited real right without any physical control over the object, irrespective of the goods being 'deemed to be pledged'. Accordingly, the *mobilia* maxim cannot apply to special notarial bonds,[554] as was the case under the Natal Act.[555] This implies that the creditor's real right is not lost should the property be transferred from the debtor to a third party, even if the third party had no actual knowledge of the bond.

Whether the special notarial bondholder should be allowed to follow the bonded property into the hands of a third party raises the following policy considerations: (1) the SMPA places an obligation on third parties to perform a search of the deeds registries before acquiring the bonded property; (2) a third party is sufficiently protected by having adequate notice of the existence of the real security right; and (3) it is economically beneficial to create a real security right that can withstand a third party obtaining control over the bonded property. Nevertheless, even though the deeds registry is publicly accessible in theory, the practical situation is that a third party wishing to know the exact nature of the real right, would have to visit the relevant deeds office and inspect the bond document using the microfilm facilities, to ascertain its exact scope.

2.5.8.4 Insolvent debtor

551 P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 616, 623.
552 R Brits *Real Security Law* (2016) at 205.
553 R Brits *Real Security Law* (2016) at 205.
554 R Brits *Real Security Law* (2016) at 253 and the reference to the *Bokomo* judgment.
555 P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 614, 623-624.

The Insolvency Act applies to real rights under both types of notarial bond. However, only a special notarial bondholder is specifically included in section 2 of the Insolvency Act as a secured creditor by registration alone, while a general notarial bondholder becomes a pledgee only once the security has been perfected through possession. Until the general notarial bond has been perfected, the bondholder enjoys preference only over other concurrent creditors of the debtor's insolvent estate.

(a) General notarial bond: preference

The holder of an unperfected general notarial bond enjoys a preference over other concurrent creditors as regards the proceeds of the encumbered *movable* assets. These are referred to as the free residue of the estate.[556] In other words, 'free residue' means that portion of the insolvent estate not subject to any right of preference due to a special mortgage, legal hypothec, pledge, or right of retention.[557] Where the general notarial bondholder has proved its claim against the free residue, but the proceeds from the sale of the encumbered property fail to cover all the sequestration costs, the bondholder must contribute towards the outstanding sequestration costs.[558] Even where the general notarial bond has been perfected, where the value of the claim exceeds the amount recovered from the sale of the asset the unsatisfied portion of the claim will be concurrent. It is also not possible for this bondholder to waive a portion of the claim for the entire claim to remain preferential.[559] The effect is that, to the extent that bondholder also has a concurrent claim, it will be asked to contribute to the insolvent estate to cover the costs of the sequestration where there is a shortfall.

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556 Section 102 of the Insolvency Act. It is settled law that this bondholder only shares in the free residue from the sale of the encumbered *movable* asset and not the free residue also available from the sale of other assets in the insolvent estate. This was confirmed in *Firstrand Bank Ltd v the Land & Agricultural Development Bank* 2015 (1) SA 38 (SCA) paras 2, 19, 25 and 40. See also the discussion of this judgment in AL Stander & HJ Klopper 'Artikel 102 van die Insolvensiewet en notariële verbande: van onsekerheid na sekerheid' (2017) 80 *THRHR* 287 at 294-300. See further JC Sonnekus 'Besitlose pandreg en notariële verbande-regsvergelykende lesse' 2013 *TSAR* 713 at 717-718, where the author concludes that even though s 102 of the Insolvency Act refers to the entire free residue, the nature of a general notarial bond as security over *movable* property should be the determining factor. This is also discussed in R Brits *Real Security Law* (2016) at 200.

557 Section 2 of the Insolvency Act.

558 AL Stander & HJ Klopper 'Artikel 102 van die Insolvensiewet en notariële verbande: van onsekerheid na sekerheid' (2017) 80 *THRHR* 287 at 294.

559 This right is reserved under s 89(2) of the Insolvency Act for secured creditors, which disqualifies the general notarial bondholder. See AL Stander & HJ Klopper 'Artikel 102 van die Insolvensiewet en notariële verbande: van onsekerheid na sekerheid' (2017) 80 *THRHR* 287 at 293.

(b) Special notarial bond: secured creditor

The holder of a registered special notarial bond over *corporeal* movables is a secured creditor in the debtor's insolvent estate provided that the bond complies with the SMPA.

Also, where the registration of the notarial bond took place shortly before the debtor's insolvency, this security right can potentially be invalidated. Section 88 applies either: (1) in the case of novation or substitution of a debt that was not previously secured; or (2) where unsecured debt becomes 'secured' through the registration of a notarial bond as security. The original debt must have been incurred more than two months before lodgement of the notarial bond. Where the debtor is sequestrated within six months of the bond having been lodged, the bondholder acquires no preference, irrespective of the fact that the special notarial bond was registered and complied with the provisions of the SMPA. This section appears to have a similar theme to the sections dealing with impeachable transactions,[560] with the difference in section 88 that the debt *already existed*, but only became secured later as a result of the subsequent registration of a notarial bond.

2.5.9 Functioning effectively to meet modern commercial needs

The creation of special notarial bonds was an attempt to create a form – albeit fictional – of non-possessory pledge.[561] Even though notarial bonds may be regarded as a non-possessory alternative to the possessory pledge construction, it remains unclear whether notarial bonds are widely used.[562] A search of Juta's *South African Law Reports* using the key term 'notarial bonds', revealed that there were some 33 cases dealing directly with the legal nature of notarial bonds.[563] This number does not accurately represent how often notarial bonds are used in that

560 See mention of impeachable dispotions in paragraph 2.4.5.2 *supra.*

561 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 273.

562 JC Sonnekus 'Omskrywing van sekerheidsopbjekte vir die doeleindes van die Wet op Sekerheidstelling deur Middel van Roerende Goed 57 van 1993' (2005) 38 *De Jure* 133 at 133 and 143. That parties are still using simulated transactions and not special notarial bonds, is a further indication that this security instrument is not widely used. See R Brits *Real Security Law* (2016) at 190 and R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 247.

563 Twelve of those cases were from the former Natal Province; another nine were decided under the Security by Means of Movable Property Act; five were decided in the former Cape Province; five in the former Transvaal; and one in the former Orange Free State. There may have been unreported cases, but the sample from reported case law is sufficient for this study to show a trend.

it represents only those cases where something went awry, forcing the parties to litigate.[564] This figure must be set against the number of notarial bonds registered in the different deeds offices to obtain a more accurate picture.

There are many possible reasons why this security device is not used more often. Commercial enterprises are possibly avoiding notarial bonds because of the high costs associated with notation and registration;[565] the cumbersome requirements in preparing the bond document;[566] uncertainty regarding whether the registered document actually complies with the strict specificity requirement and the resulting risk of a downgrade to a general notarial bond;[567] whether notaries really grasp the principles applicable to notarial bonds, resulting in many of the registered notarial bonds in circulation possibly not being worth the paper they are registered on;[568] and the limited scope of assets that can be included under a special notarial bond. The tragedy is that a creditor might only realise the inefficiency of its registered notarial bond once it is too late. It appears that the modern application of notarial bonds is used more often in general business acquisition transactions,[569] and sometimes in conjunction with franchise agreements, [570] and also in the agricultural sector.[571]

Some issues regarding practical application have emerged from this discussion of notarial bonds. It is hardly surprising that financiers are on the lookout for alternatives by which to

564 It has also been held that due to the uncertainty of the law relating to notarial bonds, that parties tend rather to settle a matter before litigating. See P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 632.

565 R Brits 'Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act' (2015) 27 *SA Merc LJ* 246 at 247 discussing costs misappropriated to the value received from registration.

566 The 'paperwork' needs to be completed by a notary and a conveyancer. However, the process leading up to the drafting of the paper is also cumbersome as it may require a proper valuation of the properties and detailed stock-taking to ensure that the correct property descriptions are included in the bond document.

567 R Brits *Real Security Law* (2016) at 245.

568 However, who can blame notaries for not understanding the law where the courts are hesitant to provide a comprehensive exposition of the law when it involves notarial bonds? See P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 632. Further, few cases come before courts and are reported as noted by JC Sonnekus 'Omskrywing van sekerheidsopbjekte vir die doeleindes van die Wet op Sekerheidstelling deur Middel van Roerende Goed 57 van 1993' (2005) 38 *De Jure* 133 at 133.

569 In *Sarwill Agencies (Pty) Ltd v Jordaan NO* 1975 (1) SA 938 (T) (business acquisition). In the *Industrial Development Corporation of South Africa Ltd v Agri Varia Holdings (Pty) Ltd* (unreported case 09697/16 delivered on 21 February 2017), a general notarial bond was registered to secure debt advanced to the amount of R10 110 000 in relation to working capital, plant and equipment, a building loan, a business support loan, and a business support grant. See also *Barclays National Bank Ltd v Natal Fire Extinguishers Manufacturing Co (Pty) Ltd* 1982 (4) SA 650 (D) where the applicants sought to enforce notarial bonds to entitle them to seize, operate, and dispose of the entire business.

570 General notarial bonds are available to secure obligations under franchise agreements. See, eg, the *Pick n Pay Retailers (Pty) Ltd* judgment and *Spar Group Ltd v Firstrand Bank Ltd* 2017 (1) SA 449 (GP).

571 It remains problematic that the security held by the Land Bank will receive preferential treatment above the security registered in terms of a special notarial bond, even if the special notarial bond was registered before the Land Bank advanced funds to the farmer (s 5 of the SMPA).

secure the payment of funds advanced. Using ownership as a security device may be an alternative, but this has received only limited and uncertain recognition in South African law. Title-based devices form the topic of the next paragraph.

2.6 Title-based security devices

Some financing devices use 'title' to secure the performance of an obligation. These devices are loosely referred to as 'title-based security devices'.[572] Generally, title-based security devices are classed either devices which: (1) reserve title to movable property; or (2) transfer title to the movable property to secure an obligation.[573] Reservation of ownership (or title) is recognised in most legal jurisdictions where the transfer of ownership is subject to a suspensive condition contained in an agreement.[574] However, security in 'owned-property' (property the debtor owns), referred to as a security transfer of ownership (*fiducia cum creditore contracta*), is not readily recognised for corporeal movable property.[575] The same general approach is applied in South Africa law.[576]

A retention-of-title clause is a widely-recognised example of a title-based security device where the reservation of ownership is included as a suspensive condition to a sale contract, thus creating a conditional sale. Further, reservation of ownership regularly forms part of credit agreements (either regulated under common law or in terms of consumer credit legislation). This distinction is explained below.

As title-based security devices fulfil the same economic function as proper security rights, these devices are occasionally referred to as *quasi*-security[577] – a term also used in the South African framework. South African real security law draws a clear distinction between

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572 'Title' is used in the common-law context, but 'ownership' is preferred in the civil-law tradition. The UNCITRAL Guide uses the umbrella term 'title-based' security device. This term is 'borrowed' for the discussion in this paragraph.

573 H Beale *et al The Law of Security and Title-Based Financing* (3rd ed 2018) at 261.

574 An ownership reservation clause, or a *pacta reservati dominie*, is entrenched in South African consumer credit legislation. See S Renke & M Pillay 'The National Credit Act 34 of 2005: the passing of ownership of the thing sold in terms of an instalment agreement' (2008) 71 *THRHR* 641 at 645.

575 The SALC report at 27 and 8. The acceptance of security transfer of ownership varies. Some countries which allow it include: the Czech Republic, Poland, and Slovakia. See J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 94, 100 and 107. These types of transfer are often referred to as 'fiduciary transfer of title'.

576 See paragraph 2.6.1.1 *infra* for a discussion of so-called 'simulated transactions', which boils down to credit secured by a transfer of title.

577 H Beale *et al The Law of Security and Title-Based Financing* (3rd ed 2018) at 261. See also NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 31.

the legal frameworks for traditional real security and *quasi*-real security. The South African approach here qualifies as a formal as opposed to a functional approach[578] – a typical characteristic of an 'unreformed secured transactions regime'[579] – and suggests that the South African legal framework applicable to title-based security devices is in need of reform.[580] Whether having a framework which follows a formal approach in itself requires the framework to be reformed, is explored further in Chapter 5.[581]

Arguably, as title-based security devices better fulfil the economic function indicated above than do possessory security rights, the former will increasingly be used.[582] Further, title-based devices are particularly common in the sphere of finance acquisition and frequently feature as part of commercial transactions.[583] An effective legal framework in respect of title-based devices arguably leads to an economic benefit and there is no question of the importance of including title-based security devices as part of a reformed secured transactions law framework. And this is why I include title-based security devices in use under the South African framework as part of this study. How a framework should incorporate title-based security devices, required a consideration of: (1) to what extent the legal rules which apply to traditional security devices can (or should) also apply to title-based security devices;[584] (2) whether a right in terms of a title-based security device must enjoy preferential treatment above a traditional security right;[585] and (3) whether title-based security devices should be publicised.

The structure of the discussion on title-based security devices differs from that followed for pledges and notarial bonds. First, the different forms of title-based security device used in

578 A functional approach would apply the same legal framework to functionally equivalent security devices.

579 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 47.

580 However, see the recommendation made in Chapter 5 paragraph 5.4.1.2 *infra* that the current title-based security devices should remain for the present.

581 See Chapter 5 paragraph 5.4.1 *infra*.

582 U Drobnig 'Present and future of real and personal security' (2003) 5 *Eur Rev Priv Law* 623 at 652. This is also true of South Africa. See DSP Cronje 'Die aard van die reg van 'n huurkoopkoper van 'n roerende saak' 1980 *TSAR* 233 at 235; DSP Cronje *Eiendomsvoorbehoud by 'n Huurkontrak van Roerende Sake* (1977)(unpublished LLD-thesis: Rand Afrikaans University) at 12; and DSP Cronje 'Eiendomsvoorbehoud en besitlose pandreg' (1979) 12 *De Jure* 228 at 230.

583 Acquisition finance involves receiving funding to purchase assets which serve as security for repayment of the purchase price. See the general rule concerning acquisition finance in Chapter 3 paragraph 3.3.4 *infra*.

584 Either changing the label to include it as a security interest (ie, using a unitary concept) or keeping the separate label, but attempting to regulate title-based security devices under the same framework (as far as possible) as traditional security devices (ie, using a uniform system for creation, perfection, priority, and enforcement of all security device).

585 CG van der Merwe & LD Smith 'Financing the purchase of stock by the transfer of ownership as security: a simulated transaction' (1999) 10 *Stell L Rev* 303 at 320. See also, Chapter 3 paragraph 3.3.4 *infra* where the preferential treatment of acquisition finance devices in terms of the UNCITRAL Guide and UNCITRAL Model Law is discussed.

South Africa are discussed. Second, the concerns associated with using ownership as security are considered. There are also specific statutory provisions relevant to the enforcement of the right contained in a title-based device. These provisions relate to the statutory hypothec in respect of an instalment agreement created under the Insolvency Act. The enforcement provisions in the NCA are also mentioned briefly in this paragraph. The final paragraph includes a synopsis of the available options on how to reform the law governing title-based security devices. This provides the basis for the discussion of acquisition financing devices in Chapters 3 and 4.

2.6.1 Forms of title-based devices known to South African law

The title-based security devices in property owned by another are loosely categorised as either: (1) a contractual provision containing a reservation of ownership in a contract of sale (a simple or an extended version);[586] or (2) a reservation of ownership included in a contract of sale which is also a credit agreement. The agreement is a credit agreement where the payment obligation is deferred, and either interest or another cost is charged as a result of the payment deferral.[587] An instalment agreement is an example of the second type in the current South African context where the transfer of ownership is suspended in terms of a contractual provision which forms part of a credit agreement.

The right under a title-based security device remains a *quasi*-real security right, with one statutory exception in case of the insolvency of the debtor under an instalment agreement as defined under the NCA.[588] The statutory exception provides the seller with a limited real right in the proceeds resulting from the sale of the encumbered asset, but only if the buyer is insolvent. The exception is discussed further in the paragraph *infra* dealing with the enforcement of title-based devices.

2.6.1.1 Reservation of ownership included in a contract of sale

586 Often referred to as a *Romalpa* clause following the seminal English decision in *Aluminium Indstrie Vaassen BV v Romalpa Alumunium Ltd* [1976] 1 WLR 676. See the discussion in NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 31.

587 R Brits *Real Security Law* (2016) at 184.

588 The only exception concerns the statutory hypothec in case of an instalment sale, contained in s 84 of the Insolvency Act. This right applies, subject to specific conditions discussed further *infra*.

Retention-of-title is a term familiar to most legal jurisdictions where the reference to 'title' can refer only to ownership. The basic definition of a retention-of-title is a contractual agreement by which the creditor (or seller) retains ownership of the movable property until the purchase price has been paid in full, effectively creating a conditional sale. This definition would qualify as a simple retention-of-title clause.[589] Variations on the basic definition relate to constructions which, in addition to securing payment of the purchase price, extend the reservation of ownership to secure the fulfilment of other contractual obligations. The variations include the current-account clause,[590] the extended clause,[591] and the aggregation clause.[592] South African law recognises simple retention-of-title clauses.[593] Even though using a simple retention-of-title clause raises certain legal issues, greater legal challenges present themselves in an attempt to use an extended retention-of-title clause.

Legal challenges ensue where a reservation of ownership is used as part of an elaborate financing scheme which attempts to bypass the control requirement under a possessory pledge[594] – more often than not, an attempt to use delivery through *constitutum possessorium.* Essentially, the parties attempt a *fiducia cum creditore contracta*, thus a transfer of ownership in assets for a security purpose. These types of scheme potentially qualify as simulated (or sham) transactions in the sense that the parties use the transactions in a particular form to bypass the legal requirements for a possessory pledge.[595] Commercial reality leads to parties structuring a transaction in a specific form (eg, as a sale-and-lease-back transaction or sale-and-buy-back transaction) while disregarding the legal substance of the transaction (a non-possessory pledge not recognised under South African law). The outcome is the creation of a

589 For the definition of a simple retention-of-title clause see RB Johnson 'A uniform solution to common law confusion: retention of title under English and US law' (1994) 99 *International Tax and Business Lawyer* 99 at 103 and G McCormack *Secured Credit under English and American Law* (2004) at 165.

590 Also referred to as 'all-monies retention-of-title clause' or 'all-liabilities clauses'. Under this clause *any* money due by the debtor must be paid before title transfer. See Chapter I of the UNCITRAL Guide para 95 at 53. This is particularly useful with revolving stock where the debtor needs an open line of credit. See also G McCormack *Secured Credit under English and American Law* (2004) at 176-181.

591 This clause extends the reservation to proceeds or receivables originating from the collateral and is also referred to as 'proceeds-of-sale clauses'. See G McCormack *Secured Credit under English and American Law* (2004) at 181-188 for a discussion.

592 G McCormack *Secured Credit under English and American Law* (2004) at 165. 'Aggregation clauses' apply where the original property is used in the manufacture of a new product.

593 See N Joubert 'Verlengde eiendomsvoorbehoud en boekskuldfinansiering'1988 *TSAR* 57 at 69 where the author states that the simple retention-of-title clause is recognised in South Africa, and that even though it is theoretically possible, the extended retention-of-title clause is not yet applied (which is still the case two decades after publication of this journal article). The author is correct that even though the extension is possible in theory, this holds catastrophic consequences for a well-established industry that uses book debts (receivables) as security for finance (at 70).

594 R Brits *Real Security Law* (2016) at 186.

595 DSP Cronje 'Eiendomsvoorbehoud en besitlose pandreg' (1979) 12 *De Jure* 228 at 235.

simulated transaction, also referred to as a 'sham device', which in law is a species of fraud (*fraus legis*).[596] In the context of this study, a simulated transaction is a transaction in which the parties attempt to conclude a transaction that has the appearance of one type of transaction (eg, a sale-and-lease-back), but in actual fact that transaction amounts to a pledge where the debtor retains possession of the collateral.[597] Accordingly, there are two legal doctrines relevant to simulated transactions: (1) the doctrine of 'substance over form';[598] and (2) an offshoot of *fraus legis*.[599]

Although simulated transactions have been used in South Africa since the 1960s for floorplan agreements[600] or similar motor vehicle finance transactions,[601] the use of such simulations goes back even further when it comes to the financing of other movable property.[602] Under a floorplan agreement, the dealer obtains a cash advance from a financier (usually a bank) for a vehicle the dealer owns. This advance must be repaid when the dealer sells the vehicle. If the vehicle is not sold within a specific time, the dealer must repay the advance to the financier.[603] From this it is clear that it is irrelevant in South African law whether a simulated transaction makes commercial sense; the only legally relevant consideration is whether the law recognises the substance of the transaction. Conversely, modern secured transactions law frameworks prefer the substance-over-form approach (the functional approach).[604] Chapter 5 expands on whether the functional approach should be adopted as part of the South African real security law framework.[605]

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596 See W Davies 'Romalpa thirty years on-still an enigma?' (2006) 4 *Hertfordshire Law Journal* at 6 where the reference is to retention-of-title devices masquerading as equitable charges under English law.

597 W Freedman '*Nedcor Bank Ltd Absa Bank Ltd* 1998 2 SA 830 (W)' (1998) 31 *De Jure* 395 at 397.

598 This doctrine forms the foundation of the functional approach discussed in Chapter 3 paragraph 3.3.3.2 *infra*.

599 This means a fraud of the law. See A Hutchison & D Hutchison 'Simulated transactions and the *fraus legis* doctrine' (2014) 131 *SALJ* 69 at 84. Fraud in law does not only relate to avoiding what the law specifically states, but also the spirit (or policy) that forms the basis of that law (at 71).

600 The use over decades was raised by counsel as a reason for the court to recognise floorplan agreements in *Nedcor Bank Ltd v Absa Bank Ltd* 1998 (2) SA 830 (W) (the *Nedcor* judgment) at 838G. See also W Freedman '*Nedcor Bank Ltd Absa Bank Ltd* 1998 2 SA 830 (W)' (1998) 31 *De Jure* 395 at 400 referring to the *Nedcor* judgment where Cloete J held that a floorplan agreement amounts to a simulated transaction and cannot transfer ownership. See further, *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC and Others* 2014 (4) SA 319 (SCA), also discussed in JC Sonnekus 'Verdraaiing van vereistes vir eiendomsverkryging van vragmotors lei daartoe dat die pad byster geraak word' (2014) 77 *THRHR* 662.

601 *Bank Windhoek Bpk v Rajie* 1994 (1) SA 115 (A) (the *Rajie* judgment).

602 *Vasco Dry Cleaners* judgment where the object was equipment used in a dry-cleaning business; the *Zandberg* judgment where the security object was a wagon.

603 *Nedcor* judgment at 836H.

604 See the discussion of the functional approach in Chapter 3 paragraph 3.3.3.2 *infra*.

605 See Chapter 5 paragraph 5.4.1.2 *infra*.

2.6.1.2 Reservation of ownership included in a contract of sale which is also a credit agreement

Title-based security devices formed and continue to be an integral part of the South African consumer credit legislation.[606] A reservation-of-ownership provision is found in early hire-purchase agreements and instalment sales (or instalment agreements).[607] A hire-purchase (and an instalment) agreement functions similarly to a retention-of-title, but more often than not there are three parties to this credit agreement.[608] South African consumer credit legislation incorporated, for the most part, the general structure of a credit agreement concerning hire-purchase agreements (previous position) and instalment agreements (the current position under the NCA). The outcome is that provisions of a particular statute will apply to that credit agreement provided that the agreement falls within the scope of the legislation in question. Previously, the definition for an instalment sale agreement according to the relevant statute was contained in section 1 of the repealed Hire-Purchase Act.[609] Thereafter, the Credit Agreements Act[610] referred to an instalment sale transaction, until this Act was repealed by the NCA. The definitions contained in the repealed legislation are not repeated as the focus of this thesis is on measuring the efficacy of the current South African law, which in this instance limits the scope to the definitions that form part of the NCA. [611]

Currently, the NCA refers to an instalment agreement.[612] It is not the purpose of this paragraph to provide a detailed discussion of the provisions of the NCA concerning instalment agreements and financial leases. The exclusive focus is to include the definitions of both forms of credit agreement to draw a parallel to the corresponding definitions contained in the

606 See S Renke & M Pillay 'The National Credit Act 34 of 2005: the passing of ownership of the thing sold in terms of an instalment agreement' (2008) 71 *THRHR* 641 at 645 and the sources listed by the authors.

607 DSP Cronje *Eiendomsvoorbehoud by 'n Huurkontrak van Roerende Sake* (1977) (unpublished LLD-thesis: Rand Afrikaans University) at 19.

608 Scottish Law Commission 2017 (2) report at 11.

609 36 of 1942 (the Hire-Purchase Act, 1942). The definition was amended by the Hire-Purchase Amendment Act 30 of 1965 (the Hire-Purchase Amendment Act).

610 This was the device under the Credit Agreements Act 75 of 1980 (the Credit Agreements Act) which replaced the Hire-Purchase Act in its entirety.

611 For a discussion of the definitions under repealed consumer credit legislation, see S Renke & M Pillay 'The National Credit Act 34 of 2005: the passing of ownership of the thing sold in terms of an instalment agreement' (2008) 71 *THRHR* 641 at 643-645.

612 Before the amendment of the NCA in 2014 by the National Credit Amendment Act 19 of 2004, was also included as part of the definition of a secured loan. The amendment removed any reference to title and on a literal interpretation, retention-of-title no longer forms part of this definition. See JM Otto 'Die impak van die Nasionale Kredietwet op die sakereg en saaklike sekerheid' 2017 *TSAR* 167 at 171.

UNCITRAL Guide (Chapter 3).[613] Therefore, as most secured transactions law reforms exclude direct application to consumer law, this is also the approach followed in this thesis.

Instalment agreements and financial leases are both title-based security devices included in the NCA and regarded as alternatives to using a pledge.[614] Under section 1 of the NCA, an instalment agreement relating to the sale of movable property, exists where: (1) all or portions of the purchase price are deferred and paid periodically (the element, along with element 4 *infra*, which qualifies this agreement as a credit agreement);[615] (2) the possession and right of use of the movable property are transferred to the debtor; (3) ownership of the movable property either remains with the creditor until the purchase price has been paid (a reservation-of-ownership clause) or the ownership is transferred with delivery, subject to the creditor's right to reclaim the object if the debtor fails to satisfy all her *financial* obligations (a repossession clause);[616] and (4) 'interest, fees, or charges' due to the creditor in relation to the agreement or the deferred amount. The vertical comparative approach followed in this study requires that the definition of an instalment agreement be compared with that of a retention-of-title in terms of the UNCITRAL Guide.

The definition of a retention-of-title in the UNCITRAL Guide is used only in the non-unitary approach to acquisition finance.[617] A right under a retention-of-title is the seller's right in a tangible asset (excluding negotiable instrument or a negotiable document)[618] in terms of an agreement which stipulates that the seller does not transfer ownership of that asset to the buyer unless the unpaid portion of the purchase price is paid. Accordingly, the Guide does not distinguish between periodic and lump-sum payments, based on the assumption that both are permitted (similar to the NCA definition of an instalment agreement). Furthermore, as in the NCA definition, the reservation clause only secures the *financial* obligation – repayment of the purchase price. The Guide has no repossession clause as the secured creditor has exchanged its

613 The UNCITRAL Guide includes a non-unitary approach where retention-of-title and financial lease are specifically distinguished from other acquisition financing devices. See Chapter 3 paragraph 3.3.4.4 *infra*.

614 Financial lease is included as the UNCITRAL Guide specifically mentions financial leases in respect of acquisition finance.

615 Lump-sum payments are not permitted, unlike the previous position under the Credit Agreements Act.

616 The creditor is only allowed to re-possess the secured asset where the debtor has not complied with the *financial* obligations under the agreement under the current instalment sale construction in the National Credit Act. See JM Otto 'Afbetalingskoop-en huurkoopkontrakte van roerende goed, vanmelewe en nou: die Nasionale Kredietwet bied interessante leesstof' (2011) 74 *THRHR* 120 at 128. I agree with Otto that, theoretically, if transfer of ownership is subject to *any* breach of contract, the instalment sale would not fall under the National Credit Act. Also, in the definition in the UNCITRAL Guide reference is made to non-compliance with a *financial obligation* as in the National Credit Act, but *contra* the Cape Town Convention definition which refers to a breach of *any* contractual obligation.

617 See Chapter 3 paragraph 3.3.4 *infra*. See the Introduction to the UNCITRAL Guide at 12.

618 The UNCITRAL Guide includes separate provisions for these assets.

right of ownership for a security right (this differs from the NCA definition of an instalment agreement). The hypothesis under the Guide is that the seller has no intention of obtaining possession of the used assets and that monetary compensation is the preferred remedy. The UNCITRAL Guide does not include a reference to a charge or cost payable as a result of the deferral of the payment obligation, as the Guide is not limited to credit agreements.

The traditional definition of an operating lease is where the use and enjoyment are *temporarily* transferred in exchange for a sum of money.[619] However, the definition of a lease in section 1 of the NCA, provides the following interesting combination of elements of both an operating lease and a financial lease. The consumer receives *temporary* possession of the movable property and payment is either made periodically or deferred to be made as a lump-sum, both during the life of the agreement. Interest, fees, or other charges are collected in respect of the agreement or the deferred amount. When the term of the agreement expires, ownership passes to the lessee either absolutely or after satisfaction of certain suspensive conditions. The definition in the NCA appears strange when compared to the common-law lease as the former includes passing of ownership, either absolutely or upon compliance with specific conditions in the credit agreement.[620] The inclusion is even more peculiar as the section refers to the delivery of 'temporary possession of any movable property' or the granting of the right to use the property – both indicative of the non-permanent the nature of the right under this agreement.[621] Further, payment in exchange for possession of the property is either made periodically during the lifetime of the agreement, or 'deferred in whole or in part' for the life cycle of the agreement, thus allowing for a lump-sum payment. Moreover, interest, fees, or charges are payable, either in respect of the agreement or the deferred amount. The inclusion of this definition for a possibly new type of statutory lease does not, regrettably, offer legal certainty. In fact, this contract appears not to be a lease in the true sense, but a lease which has been converted into a contract of sale.[622] It also remains unclear why there was a need to include

619 H Beale *et al The Law of Security and Title-Based Financing* (3rd ed 2018) at 289.

620 Section 1 of the NCA.

621 As Otto rightly states: 'Voet draai in sy graf om as hy dit moet lees' (translated as 'Voet would turn in his grave if he were to read this') referring to the inclusion of the transfer of ownership as a given in the definition of lease under the National Credit Act. See JM Otto 'Die impak van die Nasionale Kredietwet op die sakereg en saaklike sekerheid' 2017 *TSAR* 167 at 173 and JM Otto 'Afbetalingskoop-en huurkoopkontrakte van roerende goed, vanmelewe en nou: die Nasionale Kredietwet bied interessante leesstof' (2011) 74 *THRHR* 120 at 129.

622 This is similar to a conditional sale where the seller has a proprietary reclamation right that the asset will be returned when the full purchase price is tendered. However, this is regarded more as a financing instrument than a security device. See JH Dalhuisen *Dalhuisen on Transnational Comparative, Commercial, Financial and Trade Law Vol 2: Contract and Movable Property Law* (5th ed 2013) at 448.

a lease if this definition did not differ significantly from the definition of an instalment agreement set out *supra*.[623]

The UNCITRAL Guide also refers to a financial lease right which is the lessor's right in a tangible asset that is the object of a lease agreement and which falls within one of the following scenarios: (1) the lessee automatically obtains ownership of the leased object; (2) the 'lessee may acquire ownership of the asset by paying no more than a nominal price'; or (3) 'the asset has no more than a residual value'.[624] A lease agreement would imply temporary use and enjoyment in exchange for the payment of money (similar to the NCA definition of a lease). But ownership passing absolutely, implies that the lessee automatically becomes the asset's owner without having to comply with any specific conditions. The NCA definition of a lease allows the passing of ownership subject to a specific condition as an alternative to the absolute transfer of ownership.

2.6.2 Specific aspects of the enforcement of title-based security devices

The aim of this paragraph, which addresses enforcement, is twofold: (1) to discuss specific statutory provisions that influence the enforcement of a right under a title-based security device; and (2) to investigate to what extent the fact that ownership is used as security, influences the nature of the enforcement measures used for title-based security devices. Different statutory provisions may apply to the enforcement of certain types of enforcement measure. Accordingly, the enforcement framework applicable to the enforcement of different types of title-based security device will not be uniform.

Where the NCA applies to an instalment agreement or a lease, *parate executie* is not permitted.[625] Further, the seller is required to follow the debt-enforcement procedure prescribed by sections 129,[626] 130,[627] and 131[628] of the NCA. The most contentious issue as regards the application of these statutory provisions concerns the exact nature of delivery required for a

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623 According to Otto, the only clear difference is that leases can also apply to once-off payments compared to instalment sales which do not apply only to once-off payments. See JM Otto 'Die impak van die Nasionale Kredietwet op die sakereg en saaklike sekerheid' 2017 *TSAR* 167 at 173 and JM Otto 'Afbetalingskoop-en huurkoopkontrakte van roerende goed, vanmelewe en nou: die Nasionale Kredietwet bied interessante leesstof' (2011) 74 *THRHR* 120 at 130.

624 See the Introduction to the UNCITRAL Guide at 9.

625 See paragraph 2.4.5.4(*b*) *supra* where s 90 dealing with the link between unlawful conduct and *parate executie* is discussed.

626 This section prescribes the procedure required before debt enforcement can take place.

627 This section relates to the debt enforcement procedures in a court.

628 This section deals with the repossession of the hypothecated goods subject to an attachment order.

section 129(1)(*a*) default notice.[629] This discussion is not taken further, apart from mentioning that this debate appears to have been settled by the amendment of the section.[630] Further, section 127 – the voluntary surrender of the hypothecated goods – is also relevant as the credit provider takes over the asset in satisfaction of the outstanding debt.[631] As consumer law is excluded from the scope of this thesis, this discussion of enforcement measures under the NCA is sufficient. The discussion in respect of the statutory hypothec created under section 84 of the Insolvency Act, is more relevant and is discussed *infra*.

Section 84 of the Insolvency Act creates a statutory hypothec in favour of the seller (creditor) in a specific type of instalment agreement.[632] The use of a statutory hypothec rather than a special pledge is preferred, as the rights under the statutory hypothec, vest in the secured creditor without any consideration of physical control of the object.[633] This seller holds a limited real right (a statutory hypothec), which only applies when the debtor is insolvent. This limited real right effectively results in the creditor exchanging her reserved ownership for a limited real right to the proceeds of the sale of the object of the instalment sale as part of the insolvency process.[634] Nevertheless, as a creditor, this seller ranks equal to other secured creditors and does not qualify for any form of 'super-priority' above other secured creditors.[635] This applies even though the secured creditor effectively traded her right of ownership for a limited real right – albeit for insolvency purposes – as the suspensive condition which formed part of the instalment agreement was not met and ownership did not pass *ex lege* to the insolvent estate.[636]

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629 See the decisions in *Sebola v Standard Bank of SA Ltd* 2012 5 SA 142 (CC) and *Kubyana v Standard Bank of South Africa Ltd* 2014 (3) SA 56 (CC). See Renke S *An Evaluation of Debt Prevention Measures in terms of the National Credit Act 34 of 2005* (2012)(unpublished LLD-thesis: University of Pretoria); M Kelly-Louw M 'The default notice as required by the National Credit Act 34 of 2005' (2010) 22 *SA Merc LJ* 568-594; MM Fuchs 'The impact of the National Credit Act 34 of 2005 on the enforcement of a mortgage bond: *Sebola v Standard Bank of SA Ltd* 2012 5 SA 142 (CC)' (2013) 16 *PELJ* 376–392, to name but a few authors who took part in the debate.

630 Section 32 of the National Credit Amendment Act 19 of 2014 amended s 129(5), (6) and 7 of the NCA.

631 See paragraph 2.4.5.6 *supra* for a discussion of the provisions of s 127 of the NCA.

632 JM Otto 'Artikel 84 van die Insolvensiewet en die omskrywing van die afbetalingsverkooptransaksie in die Wet op Kredietooreenkomste' 2003 *TSAR* 563 at 564. See also, R Brits *Real Security Law* (2016) at 420.

633 See R Brits *Real Security Law* (2016) at 427. But the author is correct that 'nothing turns on the change' from the predecessor to s 84 – ie, s 70(1) under the Insolvency Act 32 of 1916 which referred to a 'special pledge'.

634 Ownership vests in the trustee of the debtor's insolvent estate. See *Morgan v Wessels NO* 1990 (3) SA 57 (O) at 67B-H.

635 See the discussion of the UNCITRAL Guide and Model Law where the acquisition financier obtains super-priority above other creditors as a reward for having to trade ownership for a security right.

636 R Brits *Real Security Law* (2016) at 430.

Section 84 applies to transactions which comply with the elements of the definition of an instalment agreement in section 1 of the NCA.[637] The transaction need not necessarily fall within the scope of the NCA for section 84 to apply. It appears that any instalment agreement which complies with the *definition* of an instalment agreement in the NCA, falls within the scope of section 84(1) of the Insolvency Act, even if the transaction itself does not fall within the scope of the NCA.[638]

The underlying purpose behind section 84 is to protect the seller in the event of the debtor becoming insolvent. Where the creditor becomes insolvent, there is no similar protection afforded to the debtor,[639] leaving her having to wait for the trustee to decide whether or not the instalment agreement remains in force. It further appears that the seller no longer has a right of repossession when the buyer becomes insolvent, as ownership of the encumbered asset automatically vests in the debtor's insolvent estate.[640]

Section 84 of the Insolvency Act provides statutory relief for the imbalances in the contractual relationship between the seller and the buyer resulting from including a reservation-of-ownership provision in the contract. However, the imbalances persist in a contract where the reservation of ownership does not correspond to the meaning of an instalment agreement under the NCA. With no statutory protection, the seller has the rights of an owner, while the buyer must be content with a personal right against the creditor to demand the transfer of ownership.[641] Accordingly, the nature of the right of the seller or buyer determines the enforcement measures available to each party. Where there is a reservation of ownership in an agreement, the buyer (debtor) may have physical control, but the legal consequences attached to this delivery (*traditio*) are suspended until payment of the full purchase price (the suspensive condition) takes places. In effect, even though the buyer obtains most of the rights associated

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637 See paragraph 2.6.1.2 *supra* for the definition of an instalment agreement in s 1 of the NCA.

638 See *Potgieter NO v Daewoo Heavy Industries (Edms) Bpk* 2003 (3) SA 98 (SCA) para 9 where the court held that it would be absurd to argue that where the instalment sale agreement was not subject to the Credit Agreements Act, it would not fall under s 84(1) of the Insolvency Act. Also see the approval of this interpretation of the judgment by JM Otto 'Artikel 84 van die Insolvensiewet en die omskrywing van die afbetalingsverkooptransaksie in die Wet op Kredietooreenkomste' 2003 *TSAR* 563 at 566. See also R Brits *Real Security Law* (2016) at 423 and the reference to *Van Zyl NO v Bolton* 1994 (4) SA 648 (C) at 652.

639 DSP Cronje 'Eiendomsvoorbehoud en besitlose pandreg' (1979) 12 *De Jure* 228 at 234, and SALC report at 109.

640 For the rules of property law to apply, the ownership should rather vest in the insolvent estate *after* the full purchase price has been paid – thus when the suspensive condition has been fulfilled.

641 Potentially, there are different theories as to the nature of the buyer's right. These involve a distinction between the act of transferring ownership to the buyer, and when the legal consequences of ownership become operative. See DSP Cronje 'Die verkryging van eiendomsreg deur 'n huurkoopkoper' 1979 *TSAR* 16 at 16 and DSP Cronje *Eiendomsvoorbehoud by 'n Huurkontrak van Roerende Sake* (1977) (unpublished LLD-thesis: Rand Afrikaans University) at 110.

with ownership, the seller remains the owner – albeit only of bare *dominium.* In turn, even though the buyer only becomes the owner once the full purchase price has been paid, the buyer may still conclude a contract of sale in respect of the object and even transfer possession to a third party, while providing a warranty against eviction in favour of the third-party buyer. Arguably, the seller may be able to transfer ownership (bare *dominium*) using cession to a third-party cessionary. In relation to enforcement, this raises two questions: (1) whether the seller would be able to claim the property back from the third-party buyer,[642] or, where this is not possible, claim compensation for the damages or loss of property;[643] and (2) whether the buyer may request transfer of ownership from the third-party cessionary using the contractual remedy of specific performance.

The seller in whose favour the reservation of ownership was granted, potentially holds an unfair advantage when the movable property is sold as a result of the debtor's (buyer's) default. The value of the property at the time of enforcement may far exceed the outstanding amount owed to the seller (creditor). Thus, where the title-based security device falls outside the scope of the NCA,[644] the seller may collect an unfair windfall, unless this advantage is prohibited contractually (or through legislation in the future).[645]

2.6.3 Issues associated with title-based security devices in their current legal form

The notable concerns regarding title-based security devices can be divided into: (1) a complex transaction, resulting in either a simulated transaction or creating a monopoly in respect of credit that can be granted to the debtor; (2) the lack of publicity of title-based security devices; (3) inconsistences and shortcomings in respect of enforcement measures that apply to title-based security devices; and (4) the failure of the right under a title-based security device to always extend to the proceeds and a mass or product, resulting from the original securing object. Each concern is briefly discussed.

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642 Where the third-party buyer retains possession without the seller's consent (where the full purchase price has not been paid by the buyer), arguably, the seller may use the *rei vindicatio* to take possession from the third-party buyer. This is, of course, unless the owner is estopped from applying the *rei vindicatio.* See PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 255.

643 The *actio ad exhibendum* may be enforced against the buyer as a result of an intentional act of dispossession. See PJ Badenhorst *et al Silberberg and Schoeman's The Law of Property* (5th ed 2006) at 263. Further, the seller also has an enrichment action.

644 Section 127 of the NCA requires that the credit provider account to the consumer for any surplus remaining after disposing of the movable property.

645 See the recommendation in Chapter 5 paragraph 5.4.6.2 *infra*.

A simple retention-of-title clause is recognised in South African law. However, an extended retention-of-title clause may be problematic as: (1) if the transaction qualifies as a 'sham device', the substance of the transaction is not legally recognised; and (2) where the seller also holds rights in the proceeds in the form of book debts (receivables), there may be a conflict with the rights of the financier that used receivables as security to finance an advance to the debtor.[646] Joubert is of the view that even if it is theoretically possible to recognise extended reservation-of-title clauses, it is ill-advised to use these clauses under the current law. The main argument against using an extended version is similar to the argument against extending proceeds under an acquisition security right to receivables (or book debts).[647] It is not advisable as this would place the financier of book debts (or receivables) at the disadvantage of ranking below the financier of inventory with an extended retention-of-title clause. This is even more so where there is no publicity of a title-based device that extends to proceeds.

The lack of publicity is a valid criticism of title-based security devices.[648] Where the transfer of ownership is reserved, the debtor having possession of the movable property potentially creates a false sense of her creditworthiness.[649] There is no public notice of the fact that the seller has retained ownership despite having given up possession to the debtor. Nevertheless, as the transfer of ownership depends on the delivery of the asset, requiring that this reservation should be registered should not have an influence on the transfer of the ownership in the asset to the buyer.[650]

The current enforcement measures applicable to the enforcement of title-based security devices show certain inconsistencies and raise issues. Section 84 of the Insolvency Act creates an inconsistency in the application where statutory hypothec applies in respect of an insolvent buyer, but no similar provision applies in respect of an insolvent creditor. As regards the insolvent creditor, the trustee of the insolvent estate can decide to either uphold or cancel the

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646 N Joubert 'Verlengde eiendomsvoorbehoud en boekskuldfinansiering'1988 *TSAR* 57 at 69-70. This study interprets Joubert to mean that a cession clause may be incorporated in the instalment agreement.

647 See Chapter 3 paragraph 3.3.4.6 *infra*.

648 CG Van der Merwe & LD Smith 'Financing the purchase of stock by the transfer of ownership as security: a simulated transaction' (1999) 10 *Stell L Rev* 303 at 309. See also JC Sonnekus 'Vloerplanooreenkomste, *actio ad exhibendum* en estoppel' 2012 *TSAR* 172 at 180.

649 This was one of the reasons why Belgium was one of the last European countries to recognise retention-of-title as a security device in 1997. See E Dirix 'The new Belgian Act on security interests in movable property' (2014) 23 *Int Insolv Rev* 171 at 173. See also, JC Sonnekus 'Sekerheidsregte-'n nuwe rigting?' 1985 *TSAR* 97 at 110. Further, the SALC report at 110, 111 identified the lack of publicity as a concern in respect of title-based security devices.

650 Chapter 5 paragraph 5.4.4.2 *infra* recommends the voluntary registration of title-based security device.

agreement which contains the reservation-of-ownership provisions. Also, the statutory hypothec will only apply to an instalment agreement which complies with the definition under the NCA. This excludes any other type of title-based security device and can lead to a situation where the seller receives an unfair windfall if the movable property is sold at a price which exceeds the amount owed by the debtor to the seller (creditor).[651] A title-based security device is only a *quasi*-security device and the extent to which the *pactum commissorium* will apply in this instance, may be questioned.

Whether the seller is entitled to proceeds, depends on whether she has the right to follow the proceeds into the hands of a third party.[652] Where the buyer sells the movable property to a third-party buyer, she may not have a right to the proceeds from this sale in that the owner (seller) is entitled only to identifiable proceeds. As this is a contractual arrangement, it is possible to establish whether the seller has a right to the proceeds by including a contractual provision providing for this.

Theoretically, the seller continues to hold rights in the mass or a product resulting from the encumbered asset. But where the assets are transformed and 'lose their identity', the new product belongs to the owner of the transformed product by operation of law.[653] Arguably, where the movable property forms part of a new product but has not lost its identity, the original owner may continue to own a component of the newly manufactured product. It is possible to agree contractually that the seller acquires a right in the newly-manufactured product, but this would mean that the approach to each title-based device will differ. This position remains uncertain, and uniform legal rules are required to create certainty for the seller (creditor).

2.6.4 Reform suggestions

The crux of the matter is that even though a title-based security device serves the same economic function as a non-possessory pledge, it is not a non-possessory pledge in the legal sense;[654] it is a *sui generis* security device. Brits is of the view that South African law is nearing a crossroad when it comes to the legal recognition of the use of transferred ownership as a form of security.[655] Before considering how the reform may look, the crisp question remains why

651 H Beale *et al The Law of Security and Title-Based Financing* (3rd ed 2018) at 509.
652 H Beale *et al The Law of Security and Title-Based Financing* (3rd ed 2018) at 273.
653 H Beale *et al The Law of Security and Title-Based Financing* (3rd ed 2018) at 268, 269.
654 DSP Cronje 'Eiendomsvoorbehoud en besitlose pandreg' (1979) 12 *De Jure* 228 at 233.
655 R Brits *Real Security Law* (2016) at 191.

reform in respect of title-based devices is required. The discussion of the issues associated with title-based security devices under the previous heading clearly point to why reform is necessary.

There are three potential approaches to reforming the legal framework in respect of title-based security devices. First, a simple reservation-of-ownership clause remains, but the complex reservation-of-ownership schemes which qualify as sham devices, must be rejected. If this is the option of choice, a more effective non-possessory security device should be introduced.[656] The second option is to adopt legal rules which allow legal recognition of more complex reservation-of-ownership schemes. This opens up the potential recognition of *constitutum possessorium* as a permitted mode of delivery. The third option requires amending the entire real security law framework. This option involves adopting a functional approach under which a uniform framework applies to all security devices – regardless of their 'labels', all transactions with the same economic purpose will be treated equally.[657]

The extent to which the publicity of title-based security devices is required in the modern commercial context, must still be established. Purchasing motor vehicles and equipment using instalment agreements has become the norm in commerce, and most participants in the market must surely be aware of this possibility. Further, when a creditor conducts an affordability assessment before advancing credit, an important tool is a detailed credit report generated by one of the credit bureaus. The report usually contains a summary of the debtor's credit exposure (including that of a commercial debtor) with other financial institutions. This allows the prospective creditor to identify the hypothecated assets, or at least be alerted to this possibility. The debtor also submits detailed financials, sometimes accompanied by an asset register. The submission of the additional documents makes it unlikely that a diligent creditor would be unaware of encumbrances on the debtor's assets – unless the debtor deliberately attempted to conceal these from the creditor. However, even though this information is important in the due diligence process, it does not constitute 'publicity' in the legal sense. It does however highlight the option of using credit bureaus as possible providers of a future registry of security rights.[658]

2.7 Conclusion

656 See the recommendation made in Chapter 5 paragraph 5.4.1.2(*c*) *infra*.
657 Chapter 5 paragraph 5.4.1 *infra* analyses whether this is possible for a reformed South African framework.
658 See Chapter 5 paragraph 5.4.4.2 *infra* for the recommendation to use credit bureaus to develop the movable property registry.

Chapter 2 has provided the contextual foundation of the South African legal framework applicable to three distinct types of security device: pledges; notarial bonds; and title-based security devices. The discussion of each of these devices dealt with the following aspects: scope of application of the security device; how the security right is created and becomes effective against third parties, including the methods of publicity; and the enforcement measures available under each device.

Chapter 1 alluded to the fact that to determine whether a legal framework is effective, certain elements of that framework must be examined. The discussion of these elements informed the discussion of which fundamental principles in the South African context, will eventually need to be amended if the framework as a whole is to be effective. How the different components featured as part of the above security devices,[659] is briefly summarised as part of the conclusion to this chapter. It is not yet possible to provide a definitive answer of whether South African reform should follow either the unitary or non-unitary approach; this is addressed in Chapter 5.[660]

2.7.1. Should the method of creating a security right be revised?

This question centres on the nature of the security right; whether it is a property right which is created and how this choice is impacted by the method used to create the right. There is no clear distinction between the creation and the third-party effectiveness of a security right under South African law – they take place simultaneously – save, to some extent, in the case of general notarial bonds. Under general notarial bonds, registration binds *unsecured* creditors in the event of the debtor's insolvency,[661] but possession is still required before the general notarial bondholder becomes a secured creditor both in- and outside of insolvency. The limited real right is created *and* becomes effective against a third party as soon as the constitutive act – legal possession following registration in the case of pledges and general notarial bonds; or registration in the case of special notarial bonds in terms of the SMPA – takes place. Consequently, until the constitutive action has occurred, the creditor has only a personal right against the debtor. She has no claim to the asset intended to serve as collateral for the secured transaction.

659 See Chapter 1 paragraph 1.4 s*upra* which lists these elements.
660 See Chapter 5 paragraph 5.4.1 *infra*.
661 The bondholder enjoys priority above other unsecured creditors as a result of registration.

The economic purpose of using pledges, notarial bonds, and title-based security devices is the same, but title-based devices are created contractually, using ownership as security. The question is then to what extent it would be possible to create a single South African legal framework that regulates all secured transactions. There are three possibilities:[662] (1) is it possible to use a unitary approach that recharacterises all security devices as a security right, using a functional approach? (2) is it possible to use a uniform system of rules, but not recharacterise the traditional security devices by adopting a functional approach? or (3) is it possible to use a commercially facilitative approach which does not necessarily adopt a functional approach? [663] The choice to use a functional approach implies that the requirements set for other security devices must be brought closer in 'form' to a title-based security device, which is essentially created contractually (there is no constituting act). The statutory hypothec available under section 84 of the Insolvency Act, potentially reflects a willingness by the legislator to acknowledge the potential in using a functional approach to create a uniform system for all types of security device. Also, the limited real right in incorporeal movable property established under a cession *in securitatem debiti*, is created by an intention to transfer the claim (thus contractually). Delivery of a document to complete the cession is only required where the pledgee needs this document to exercise legal control over the incorporeal movable property.

Ultimately, the question is whether it is possible to create a property right by contract where the conclusion of a real agreement will allow the creditor access to the debtor's asset before meeting the publicity requirement. As regards a contractually-created property right, the right will apply *inter partes* until the publicity requirement has been met.[664]

2.7.2 How comprehensive (inclusive) should the scope of the secured transactions law framework be?

There is a link between whether, in law, a framework functions effectively and the scope of that framework. The measure for how comprehensive a framework depends on the extent of assets permitted to serve as security, the nature of obligations the framework may secure, and the type of secured transaction potentially accepted as part of the framework. The meaning of

662 These possibilities are analysed in Chapter 5 paragraph 5.4.1.1 *infra*.
663 Option 3 is the structure recommended by the EBRD framework discussed in Chapter 4 *infra*.
664 See the recommended approach in Chapter 5 paragraph 5.4.3.2 *infra*.

'effective' in the context of the legal framework applicable to security rights in movable property is explained in Chapter 1.[665]

The security device should be able to fulfil the legal function of providing the secured creditor with adequate access to the debtor's assets to secure any type of contractual obligation. Accordingly, sufficient assets should be available to secure the contractual obligation. This requires the debtor to be able to use the full inherent value of all types of property the debtor owns. The following factors impact on the type of asset that may be used as security: (1) the effect of the specificity principle (which applies to special notarial bonds in terms of the SMPA); (2) the extent to which revolving assets form part of the current framework (this is not possible in terms of special notarial bonds in terms of the SMPA); (3) the possibility of taking security in future assets (which is possible under a pledge and an unperfected general notarial bond); (4) whether and the extent to which the security right extends to proceeds of the collateral; (5) whether it is possible to take an entire business enterprise as security (which is theoretically possible under an unperfected general notarial bond); (6) whether and the extent to which the security right extends to a product or a mass, of which the original encumbered asset forms part; and (7) whether incorporeal movable property is included or excluded under a specific security device (specifically excluded in respect of a special notarial bond in terms of the SMPA). The application of each factor is considered briefly below.

Influence of the strict specificity principle: The strict test for specificity under the SMPA was included as a result of creating a 'deemed pledge' in preference to a *sui generis* security device. The thinking behind equating a non-possessory security device with a possessory device is outdated and unhelpful. In any event, having this strict test for specificity serves no purpose where the detailed asset description is contained in a bond document available to relatively few people. The precise level of description must, therefore, be re-evaluated. A more flexible alternative but which still provides reasonably adequate identification, should be adopted.[666] There is a paucity of case law on the possible description and identification methods, and these are elements that need to be included in future reform. Also, the registration

665 Chapter 1 paragraph 1.2 *supra*.

666 For example, s 6 of the Nigerian Secured Transactions in Movable Assets Act 3 of 2017, refers to an adequate description of collateral.[666] It then goes further by including a closed list of what is meant by 'adequate'.

method envisaged for future reform must complement the methods used to describe the encumbered asset.[667]

Inclusion of revolving assets: It is not possible to register a special notarial bond, in terms of the SMPA, over revolving assets. This limitation is also a result of the application of the specificity requirement. In any event, it was never intended that revolving assets should form part of a special notarial bond as contemplated in the SMPA. Nevertheless, a general notarial bond can be registered over a revolving-type asset. However, it is not possible to register a general notarial bond *solely* over the debtor's stock while excluding her other assets; the notarial bond must be registered over all the debtor's assets. A bond which singles out individual assets or assets which form an economic entity (eg, stock-in-trade) amounts to a special notarial bond, either in terms of the SMPA (depending on whether the requirements are met), or in terms of the common law. It goes without saying that the possessory nature of a pledge (the pledgor retains physical control over the pledged object) means that a pledge cannot exist in respect of revolving assets.[668]

Future assets included or excluded: It is possible to take a pledge and register a general notarial bond over future assets. Nevertheless, until perfection takes place, the creditor only holds a personal right against the debtor, with no direct recourse to the debtor's assets. The application of the specificity principle (as manifested in the description requirement in the SMPA) makes it impossible to register a special notarial bond in respect of the future property. Even though covering bonds were not discussed in detail, it is possible to register a covering bond in respect of future debt. Also, cession *in securutatem debiti* in respect of a future personal right is possible.[669]

Extending a security right to proceeds: The feasibility of adopting an extended definition of 'proceeds' similar to that under the UNCITRAL Guide, should be considered. However, this should be limited to identifiable proceeds. Also, as regards title-based security devices, only cash proceeds should be included to avoid a potential conflict with the financier who takes cession of the book debts.[670]

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667 See the recommendation regarding the standard of the asset description in Chapter 5 paragraph 5.4.2.1(*b*) *infra*.

668 Chapter 5 paragraph 5.4.1.2(*c*) *infra* recommends adopting a dynamic type of registered pledge which would allow revolving assets to be included.

669 Chapter 5 paragraph 5.4.2.1(*c*) *infra* recommends that it should be possible to register the registered pledge in respect of future assets.

670 Chapter 5 paragraph 5.4.2.1(*c*) *infra* recommends that it should be possible to register the registered pledge in respect of proceeds.

Extending a security right to a mass, product, or to attached movable property: In the case of *specificatio, commixtio,* and *confusio* the real right does not extend to the new product or mass. The creditor needs to institute either a contractual claim against the debtor, or an enrichment claim against the third party. However, the creditor no longer holds any security. One option is to extend the real right to the mass or product, but limit the amount the secured creditor can claim to the value of the original secured object.[671] As this option makes commercial sense, some frameworks have either suggested or already implemented it.[672]

Extending the security right in respect of a business enterprise: A general notarial bond can be used to create a security right in an enterprise. However, this requires an enforceable perfection clause and specific provisions on how the business must be taken over.[673] Therefore, it is arguable that the current South African law does not contain a legally effective way of utilising a whole enterprise for security purposes. This lacuna should be considered in any future reform initiative. The available alternatives are canvassed and posed against the South African framework in Chapter 5.[674]

Including incorporeal movable property: Incorporeal property cannot be the object of a special notarial bond under the SMPA, despite its being used commercially and also often being very valuable. It is possible to register a general notarial bond over incorporeal movable property. One of the recommendations on the reform of the law of movable transactions published by the Scottish Law Commission, was the introduction of a statutory pledge in respect of corporeal movable property and *limited* categories of incorporeal movable property (intellectual property, and financial instruments, but not receivables) be created through registration.[675] To include incorporeal movable property under a registered pledge is also the initial suggestion for the South African reform.[676]

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671 Chapter 5 paragraph 5.4.2.2 *infra* recommending this approach for South Africa.

672 This is recommendation in terms of the UNCITRAL Guide (see Chapter 3 paragraph 3.3.3.1 *infra*) and the Belgian Pledge Act of 11 July 2013 (ss 18 and 20) where the security right in a mass or a product extends on a proportional basis.

673 The enterprise charge under the EBRD Model Law offers a possible solution where reference is included to the administration of such a business. This could be similar to the provisions followed under business rescue.

674 See Chapter 5 paragraph 5.4.2.1(*d*) *infra*.

675 The recommendations that dealt with assignations of claims was published in volume 1 of 3, and volume 2 also referred to certain incorporeal movable property. The suggestion is to create a Register of Assignations. This is included in the long title to the draft Moveable Transactions (Scotland) Bill. Also see, Scottish Law Commission 'Business and Regulatory Impact Assessment' (the Business and Regulatory Impact Assessment) at 17 available at https://www.scotlawcom.gov.uk/files/7415/1359/9231/Business_and_Regulatory_Impact_Assessment_Report_on_Moveable_Transactions_Report_No_249.pdf (date of access: 3 July 2018).

676 Chapter 5 paragraph 5.4.2.1 *infra*.

In respect of the types of secured transaction that form part of the existing South African framework, the legal framework applicable to real security rights and *quasi*-security rights are very different. As the discussion of the creation of the security right addressed this difference, it is not repeated here.

2.7.3 What is the best method for third-party effectiveness?

The registration of a special notarial bond is a form of transaction filing, albeit with additional notarial attestation of the bond. Using transaction-filing as opposed to notice-filing is not necessarily an issue under the current framework; the concern is rather the design of the current registration system (an immovable property title registration). The current system is costly, cumbersome, and it does not provide effective public access to the registry.[677] The system is costly as a notary and a conveyancer (both attorneys) attend to the registration of the bond on behalf of the parties. The procedure for registering a bond is also cumbersome in several regards. The process remains paper-based and potentially takes longer than a week because of the number of examiners required to assess the legal validity of the bond document.[678] Furthermore, information: (1) on the existence of a notarial bond; and (2) contained as part of the bond document, is not widely accessible. Even where the creditor can pay to obtain an electronic confirmation that the notarial bond has been registered,[679] this confirmation only endorses that a specific debtor has a notarial bond registered against her assets. The creditor can only obtain more information by either: (1) requesting additional details of the bonded property from the debtor (as part of the due diligence process before granting credit);[680] or (2) visiting the office of the deeds registry to view the microfilmed copy of the actual bond document.[681]

A consideration for South African reform is whether notice-filing or transaction-filing should be preferred. This choice between filing systems depends in part on whether or not the

677 The public access needs to be effective. See N De La Peña 'Reforming the legal framework for security interests in mobile property' (1992) 2 *Unif L Rev* 347 at 349.

678 However, this may change in the foreseeable future. The Electronic Deeds Registration System Act 19 of 2019 was signed into law and will become effective on the date to be proclaimed (see *GG* 42744 of 3 October 2019). The purpose of the new system is to allow the electronic processing, preparation and lodgement of documents with the Registrar of Deeds.

679 There are companies who provide a paid service in this respect.

680 This is not different to notice-filing, which only provides a 'warning flag' that a security right potentially exists.

681 The information may potentially become available electronically as soon as the Electronic Deeds Registration System Act 19 of 2019 comes into operation.

reform incorporates the unitary concept of a security right (or interest). The unitary approach implies that the creation and perfection of the security right need not occur simultaneously. Notice filing is merely a warning that a security right potentially exists. This differs from the current South African position where the limited real right has third-party effect as soon as it is created. Further, the choice between the filing systems must be informed by the practical needs of commerce. This links to the extent of the due diligence process which a prospective creditor must follow before extending credit to a debtor. The creditor potentially only needs a 'warning' of the possibility of security right before conducting its due diligence process in this regard. If this is the case, it is preferable to have an up-to-date electronic system, rather than a filing system which provides more information, but which takes time to reflect encumbrances in respect of the debtor's assets. Another consideration is whether an error in the filed documents invalidates the security, or whether the security continues provided that the information is not misleading for the reasonable searcher.

A final consideration is to include a filing system in which the security right in both corporeal and certain incorporeal movable property is documented.[682]

2.7.4 How predictable and transparent are the current priority rules?

The priority rules which dictate the ranking of South African creditors are relatively clear, although there are certain complexities. First, a special notarial bond is subject to any encumbrances that existed in the bonded priority before registration.[683] Potentially, as a special notarial bond does not require delivery, the bondholder may be defrauded into registering a bond over property where delivery has already secured a right under a pledge.[684] Also, the special notarial bond stands in a potentially prejudicial relationship to certain rights held by the state and other institutions (as regards agricultural finance). Certain statutory security rights in favour of the state or another institution can rank higher than a right under a special notarial bond, even where the registration of the notarial bond was 'first-in-time'. Indeed, in developing a commercially viable and integrated legal framework, future reform initiatives must re-evaluate the preference structure.

682 See the recommended registration method in Chapter 5 paragraph 5.4.4.2 *infra*.
683 Section 1(1) of the SMPA. See also the discussion in R Brits *Real Security Law* (2016) at 256-258. See Chapter 5 paragraph 5.4.4.2 *infra*.
684 R Brits *Real Security Law* (2016) at 258.

The remaining question as regards the reform of the priority rules is whether any type of creditor should hold an even higher priority ranking than is currently the position. This may involve creating an exception to the current priority rules. The current framework allows a specific exception to the general priority rule where the addition results in achieving an intended policy objective. Potential exceptions include: (1) creating a super-priority in favour of an acquisition financier; (2) allowing that the priority in respect of a future asset serving as collateral, be determined with reference to an earlier registration date (registration which took place before the security was constituted);[685] and (3) allowing the parties to subrogate their priority ranking contractually.

As regards acquisition finance, as already stated, under section 84 of the Insolvency Act the creditor becomes a secured creditor under an instalment agreement when the debtor becomes insolvent. However, despite having been granted a security right in exchange for its reservation of ownership, this creditor does not attract a priority higher than that of other secured creditors. This needs to be amended if this corresponds to the policy choice of a country. Nevertheless, the holder of a statutory hypothec does not rank above other secured creditors. This is contrary to the super-priority of acquisition secured creditors recognised in the UNCITRAL Guide; the UNCITRAL Model Law; the Model Inter-American Law on Secured Transactions (OAS Model Law); holders of a purchase money security interest (PMSI) under UCC Article 9; and legal regimes following this framework. In light of this overwhelming global trend, it is necessary to consider whether in South Africa too, the law should be reformed to allow an acquisition financier to enjoy a super-priority over other secured creditors.

2.7.5 Efficacy of enforcement mechanisms

Effective enforcement will ideally consider a proper balance between the rights of the debtor, creditor *and* third parties.[686] Effective enforcement boils down to three requirements: proper notification of the enforcement measures to the debtor; enforcement which complies with the

685 A covering bond already allows for the registration date to be used to determine priority, despite the asset only existing in the future.

686 It appears as if South African law is more eager to protect the interest of a third party than the creditor who actually carries the credit risk. See P Sacks 'Notarial bonds in South African law' (1982) 99 *SALJ* 605 at 636.

standard of commercial reasonableness; and a debtor who has *access* to a court to defend her rights.[687]

Some of the extrajudicial enforcement measures in the legal instruments discussed in Chapters 3 and 4 are similar to enforcement measures currently available to a South African creditor in terms of a *parate executie* cause, and a clause involving a *quasi*-conditional sale.[688] Nevertheless, as regards a perfection clause, current South African law does not allow the secured creditor to take possession of the encumbered property without a court order. What is required is an expedited judicial process which corresponds to the general theme of the expedited enforcement proceedings intended under the OAS Model Law discussed in Chapter 4.[689]

Parate executie does not amount to self-help and, as it currently stands, is also not unconstitutional with respect to movable property. *Quasi*-conditional sales should continue to be recognised but must not be confused with a *pacta commissoria.* The concern appears to centre on the requirement that the object must be sold at fair market value. It might, therefore, be worth considering the possibility of introducing a requirement that before a conditional sale or *parate executie* takes place, or even before an enforcement notice is issued, the value of the asset must be determined by an independent evaluator (as is recommended by the OAS Model Law).[690] Furthermore, the law must distinguish between the protection it affords to commercially savvy parties, and that afforded to more vulnerable consumers. The correct approach would be to prohibit extrajudicial enforcement of consumer transactions, but allow greater party autonomy for commercial transactions.

2.7.6 Concluding remark

This chapter has provided a contextual discussion of the South African legal framework for specific security rights (pledges, notarial bonds, and title-based devices) in corporeal movable property. The elements of the legal framework for the three security devices were analysed under the heads: how the real rights are created; the scope of application of each security device; the method used to perfect the security; whether the priority rules presented any legal

687 E Dirix 'Remedies of secured creditors outside insolvency' (2008) 5 *ECFR* 223 at 241.
688 See the discussions *supra* in paragraphs 2.3.3.3(*j*), 2.4.5.4 and 2.5.8.
689 See Chapter 4 paragraph 4.3.3.6(*b*) *infra*. See also the recommendation in Chapter 5 paragraph 5.4.7.2 *infra*.
690 See Chapter 5 paragraphs 5.4.7.1(*c*) *infra* for an analysis of this option, and 5.4.7.2 *infra* for the recommendation to adopt this approach for South Africa.

challenges or uncertainty; and whether the enforcement measures not only made commercial sense, but adequately protected the rights of all the parties involved. The discussion above serves as the backdrop against which the vertical comparative study in the remainder of the thesis will be conducted. Accordingly, the following chapter examines international reform efforts for secured transactions law and how these may inform South African reform efforts.

CHAPTER 3
INTERNATIONAL SECURED TRANSACTIONS LAW FRAMEWORK

3.1 Introduction and background

The driving force behind the impetus for secured transactions law reform is due, in the main, to the international efforts within this field.[1] International organisations which concern themselves with secured transactions law all have the same goal: to develop an 'efficient' legal regime to regulate secured transactions.[2] Ideally, all legally efficient secured transactions law frameworks should have the same features, even though domestic frameworks will never look *exactly* the same. Including uniform features as part of different frameworks will also make it possible for a foreign security interest (or right) to be enforced in a different domestic jurisdiction, as the domestic legal systems would share the same functional features.

The international best practice is included either as part of a model law or a legislative guide. Thus, the international instruments considered in this chapter represent the outcomes of a collaborative product of working groups consisting of experts in this field, who recommend modern universal principles – a model law or a legislative guide – that should ideally form part of a secured transactions law framework. The most prominent international efforts include those by UNCITRAL,[3] UNIDROIT,[4] the Hague Conference on Private International Law (an

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1 See J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 309-316 and G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 11-14 and 102-103 for a synopsis of the international and regional force behind secured transactions law reform. See also CR Reitz 'Globalization, international legal developments, and uniform state laws' (2005) 1 *Loy L Rev* 301 at 301-327 for a discussion of the how international organisations create laws on a global scale.

2 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 13.

3 United Nations Commission on International Trade (UNCITRAL). See nn 64-66 *infra* for a list of the UNCITRAL instruments.

4 International Institute for the Unification of Private Law (UNIDROIT). The UNIDROIT instruments relate, in the main, to high-value assets. These include: the UNIDROIT Convention on International Interests in Mobile Equipment (2001) (Cape Town Convention) available at http://www.unidroit.org/instruments/security-interests/cape-town-convention (date of access: 11 November 2014) (the instrument has already entered into force). Three protocols to the Cape Town Convention have been adopted: the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment (2001) (Aircraft Protocol); the Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock (2007); and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets (2012). UNIDROIT is also busy working on the adoption of a fourth protocol to the Cape Town Convention – Draft Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Mining, Agricultural and Construction Equipment (MAC Protocol). See the UNIDROIT

organisation is not historically known for producing soft-law instruments), whose broad mandate includes legal reform, and the World Bank with an economic mandate to promote the importance of legal reform to economic development. Most of these international organisations go beyond simply drafting legal instruments that a country may use as inspiration for law reform; they also offer technical assistance on how the secured transactions law reform they recommend may best be implemented at a national level.

The extent to which the content of the international instruments is incorporated as part of domestic law depends on whether the international instrument is either a soft-law instrument or a hard-law instrument. The international trend in commercial law reform tends to favour soft-law instruments as inspiration for law reform as they embody elements a hard law instrument – eg, a treaty or convention – cannot meet.[5] Nevertheless, the Cape Town Convention and its Protocols are an example of an industry-specific, hard-law instrument, widely accepted as one of the most successful international secured transactions law instruments to date.[6] However, the discussion in this chapter is limited to those *soft-law* instruments with a *general* application in secured transactions law. Accordingly, the discussion excludes a detailed analysis of hard-law instruments which generally regulate a specific industry, as is the case under the Cape Town Convention. A synopsis of the important features of the Cape Town and its Protocols is sufficient for purposes of this thesis and is included as part of the discussion of hard-law instruments and their influence on secured transactions law reform.

This chapter introduces the link between soft-law instruments (and to some extent the Cape Town Convention as a hard-law instrument) and secured transactions law reform. The focus then moves to key policy objectives and fundamental principles (policies) that form part

website https://www.unidroit.org/work-in-progress/mac-protocol (date of access: 30 May 2018). See also, the UNIDROIT Convention on International Factoring (1998) available at https://www.unidroit.org/instruments/factoring (date of access: 10 March 2018). See further the UNIDROIT Convention on International Financial Leasing (1988) available at https://www.unidroit.org/instruments/leasing/convention-leasing (date of access: 10 March 2018); the UNIDROIT Model Law on Leasing (2008) available at https://www.unidroit.org/instruments/leasing/model-law (date of access: 10 March 2018); and the UNIDROIT Convention on Substantive Rules for Intermediated Securities (Geneva 2009) available at https://www.unidroit.org/instruments/ capital-markets/geneva-convention (date of access: 10 March 2018).

5 HD Gabriel 'The advantages of soft law in international commercial law: the role of UNIDROIT, UNCITRAL, and the Hague Conference' (2009) 34 *Brook J Int'l L* 655.

6 The success of the Cape Town Convention is largely attributed to its unique legislative structure, discussed further in paragraph 3.2.1 *infra*.

of the UNCITRAL framework as soft-law principles.[7] The analysis shows how specific legal instruments under the UNCITRAL framework incorporate the fundamental principles (policies) recommended as the foundation for a secured transactions law framework.[8] This analysis is closely linked to a functional examination of certain elements of a secured transactions law framework to evaluate whether or not a specific framework is effective, and to compare the principles and rules between frameworks as functional equivalents. The investigation in this chapter provides the foundation for the main recommendation of this thesis: to propose a framework within which to reform South African law in respect of security rights in movable property – a framework that is attuned to global trends and, more importantly, international best practice regarding an *effective* secured transactions law framework.

3.2 Hard law and soft law contributing to secured transactions law reform

A vertical comparative study is a useful source of inspiration in respect of secured transactions law reform. It implies that a country does not look to another legal jurisdiction *per se*, but considers international or regional instruments as inspiration for law reform.[9] Traditionally, private-law harmonisation made use of conventions, a hard-law instrument, to influence law reform. There are, however, valid objections to using a convention aimed at harmonising private law. Firstly, a convention is a very specific instrument which leaves little room for an adopting country to enjoy legislative flexibility as to how to incorporate its provisions as part of domestic law.[10] More specifically, ratification of the convention requires that the country adopt national legislation which closely reflects the wording of the convention.[11] Also, it is not only a tedious and time-consuming process to negotiate a document capable of being adopted by most countries; the implementation process is also time-consuming.[12] By the time the provisions make their way into domestic law, the law is outdated and its commercial relevance questionable.

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7 See Chapter 1 *supra* at paragraph 1.3 for the relationship between key objectives and fundamental principles.

8 Even though the Guide refers to 'fundamental policies', I submit that 'fundamental principles' means the same, which term is also preferred in SV Bazinas 'Key objectives and fundamental principles of the UNCITRAL Legislative Guide on Secured Transactions' (2008) 1 *Insolvency Restructuring International* 42-48. Also, the term 'fundamental principles' coincides with the use of 'fundamental principles' that form part of a domestic property law system. See Chapter 1 paragraph 1.5.2.3 *supra*.

9 See Chapter 1 at paragraph 1.1.1 *supra* for a broader discussion of the meaning of a vertical comparative study.

10 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 21.

11 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 20.

12 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 20.

Even though other conventions had already dealt with aspects of secured transactions law long before the adoption of the Cape Town Convention,[13] this convention is perhaps the most successful hard-law instrument dealing with secured transactions law.[14] The high adoption rate of the Cape Convention (and the Aircraft Protocol) is potentially a result of: (1) the extensive scheme of declarations to either opt-in or opt-out of a provision,[15] with due consideration of domestic law (thus, a state can decide that specific provisions do not apply to it); and (2) having the two-instrument approach, which implies having the principal Convention and Protocols in respect of different types of high-value mobile equipment, where the Convention is regarded as the 'umbrella treaty' and the Protocols are drafted keeping in mind the industry-specific requirements.[16]

Despite the apparent success of the Cape Town Convention, the in-depth discussion in this chapter is limited to those *soft-law* instruments with *general* application to secured transactions law. The trend in secured transactions law reform favours the use of modern soft-law instruments for law reform of a *general* nature. Hard-law instruments are favoured in the case of reforming the law applicable to a *specific* industry (as is the case with the Cape Town Convention). In any event, South Africa has ratified and acceded to the Cape Town Convention and the Aircraft Protocol, and both instruments are already in force under South African law.[17] Consequently, the provisions of the Cape Town Convention and the Aircraft Protocol already form part of current South African law. Nevertheless, it would be remiss if this study did not provide a synopsis of the main features of the Cape Town Convention before venturing into the discussion of the soft-law instruments.[18]

3.2.1 Hard law and secured transactions law reform: the Cape Town Convention

13 Examples include the UNIDROIT Convention on International Financial Leasing (1988); the UNIDROIT Convention on International Factoring (1998); the UNIDROIT Convention on Substantive Rules for Intermediated Securities (Geneva 2009); and the UN Convention on the Assignment of Receivables in International Trade (2001), to name but a few.

14 The Cape Town Convention was built on principles contained in the UNIDROIT Convention on International Financial Leasing (1988). See R Goode 'From acorn to oak tree: the development of the cape Town Convention and Protocols' (2012) 17 *Unif L Rev* 600.

15 This is generally referred to as a reservation clause.

16 CW Mooney Jr, M Dubovec and W Brydie-Watson 'The Mining, Agricultural and Construction Equipment Protocol to the Cape Town Convention Project: the current status' (2016) 21 *Unif L Rev* 332 at 335.

17 The Cape Town Convention and the Aircraft Protocol entered into force in South Africa on 1 May 2007. See https://treaties.dirco.gov.za/dbtw-wpd/exec/dbtwpub.dll) (date of access: 4 August 2019).

18 The main features link to the fundamental principles of the UNCITRAL instruments discussed *infra*.

The Cape Town Convention (CTC) and its Protocols are an example of an *industry-specific* hard-law instrument.[19] More specifically, the CTC addresses the industry-specific issues in respect of 'the instability of security, title retention, and leasing interests' when dealing with high-value, mobile equipment.[20] The CTC has a unique international-law-making character. The Convention and its Protocols effectively introduced a 'two-instrument approach'. This approach involves a convention which is not industry-specific (eg, the 'umbrella treaty'), supplemented by industry-specific Protocols, keeping in mind the commercial context and needs of a particular sector (hence the Protocol being classified as an industry-specific instrument).[21] Accordingly, each Protocol adapts the provisions of the CTC to address the unique challenges and context of specific types of mobile equipment and address the issues unique to a specific industry.[22]

The CTC creates a uniform legal regime for the creation, perfection, priority, and enforcement of specific categories of high-value mobile equipment.[23] Consistency is achieved by using a uniform international security interest in respect of specific mobile equipment. Effectively, the international security interest has established a *sui generis* security device. The international security interest is appropriate when dealing with mobile equipment – equipment likely to move across country borders. This international interest is either granted (in respect of a security agreement), or vests in a person who is the conditional seller (under a title-reservation agreement), or a person who is a lessor (under a leasing agreement).[24] As prescribing a uniform approach for all countries is impractical, it is left to the law of the contracting state to determine into which of these three categories the agreement will fall.[25] There is, therefore, not a re-characterisation of the domestic security devices, but where the domestic security meets the definition of defined agreements and the creditor has complied

19 For this thesis, the reference to the Cape Town Convention will be only to the Convention. Where the text requires reference to a Protocol, this is explicitly stated.

20 R Goode 'The international interest as an autonomous property interest' (2004) 1 *Eur Rev Priv Law* 18 at 19.

21 R Goode 'The international interest as an autonomous property interest' (2004) 1 *Eur Rev Priv Law* 18 at 20. See also S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 8, 9.

22 CW Mooney Jr, M Dubovec and W Brydie-Watson 'The Mining, Agricultural and Construction Equipment Protocol to the Cape Town Convention Project: the current status' (2016) 21 *Unif L Rev* 332 at 335.

23 Groups of mobile equipment included in the scope extend to: aircraft objects (which provides for airframes, aircraft engines, and helicopters); railway stock and space assets (art 2(3) of the Cape Town Convention).

24 Article 2(2) of the Cape Town Convention.

25 Roy Goode 'The international interest as an autonomous property interest' (2004) 1 *Eur Rev Priv Law* 18 at 23. See also S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 9.

with additional requirements in article 7 of the CTC, a uniform system of regal rules will apply to the international interest.

Lenders, sellers, and lessors must be satisfied that their security interest persists and that they will be able to enforce a security interest in the legal jurisdiction where the mobile equipment is located.[26] Accordingly, it is possible to enforce the international interest in any state that is a party to the CTC, as long as the agreement (ie, the security agreement, title-reservation agreement or the lease agreement) complies with the requirements contained in article 7 of the CTC, as mentioned *infra*.[27] The priority ranking of this international interest depends on the date the international interest is registered in the international registry discussed further *infra*. Nevertheless, this right of enforcement is subject to declarations made by the contracting state – eg, whether or not it will accept self-help as an enforcement remedy.[28] In simple terms, this means that the international security interest exists regardless of the provisions of domestic law and is enforceable in all countries who have ratified the Cape Town Convention and the Protocol that applies to the specific category of asset. However, as the international interest is an autonomous interest, it is irrelevant whether there is an equivalent right under domestic law.[29]

More often than not, the security right under national law will, in any event, comply with the definition of international interest. Potentially, where the domestic security right is created, a stronger international interest is simultaneously established,[30] but subject to the domestic security right complying with those formal requirements needed to constitute an international interest.[31] These formal requirements include: (1) that the agreement (meaning any of three types of agreement mentioned *supra* must be in writing; (2) that the interest relates to an object in which either the chargor, conditional seller, or lessor is able to dispose of; (3) that the mobile equipment can be identified as equipment that is subject to a *specific* Protocol;[32] and (4) only

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26 R Goode 'The international interest as an autonomous property interest' (2004) 1 *Eur Rev Priv Law* 18 at 19.

27 Article 3(1) of the Cape Town Convention.

28 The opt-in declaration has the effect that a specific provision of the Cape Town Convention will only apply if the adopting state makes a declaration in respect of the particular provision. An opt-out declaration then excludes an application of a provision (eg, art 54(2) in respect of allowing extrajudicial enforcement). See S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 14.

29 R Goode 'The international interest as an autonomous property interest' (2004) 1 *Eur Rev Priv Law* 18 at 24.

30 R Goode 'The international interest as an autonomous property interest' (2004) 1 *Eur Rev Priv Law* 18 at 24.

31 The legal requirements are contained in art 7 of the Cape Town Convention.

32 This means that the different Protocols prescribe different requirements for mobile equipment that would fall under each Protocol.The identification method differs between Protocols as a result of the different

in respect of a security agreement, that it is possible to determine the extent of the secured obligation without the need to include any sum or a maximum sum that is secured (thus there is no specificity requirement in respect of describing the principal debt).

Two features of the CTC and its Protocols require further discussion: the international registration system; and the enforcement measures available to the secured creditor. The CTC – specifically, the Aircraft Protocol which is the only Protocol that has entered into force[33] – introduced an electronic registry which operates with virtually no human involvement.[34] The registry is accessible worldwide, and the registration system is object-based (as opposed to being debtor-based).[35] Chapters IV, V, VI, and VIII of the CTC relate to the international registration system. The international registry uses a notice-filing system (also the method suggested by the UNCITRAL instruments discussed *infra*). The implication of implementing a notice-filing system is that registration is not a *conditio sine qua non* for determining whether the security interest is valid or not.[36] Notice-filing merely presents a 'warning' that an international interest potentially exists. It is not intended to provide complete information on the international security interest in the object; it is an example of a negative registry.[37] The registry also relies on a first-in-time registration, which results in priority for the security interest above any unregistered interest or other interest subsequently registered.[38] The registration is valid as soon as the required information has been entered in the registry to allow it to become searchable. In simple terms, a sequentially-ordered file number is assigned when the registration takes place and this number is stored for subsequent access.[39] The registry

characteristics of the mobile equipment. This should not be confused with the 'asset description', where the 'identification' concerns being able to classify the equipment as a type that fits under a specific Protocol.

33 Only the Aircraft Protocol has entered into force. Consequently, the existing registry concerns the financial interest in aircraft. See S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 5.

34 For a general discussion of the computerised nature of the registry see BP Honnebier 'The fully-computerized international registry for security interests in aircraft and Aircraft Protocol that will become effective toward the beginning of 2006' (2005) 70 *J Air L & Com* 63-82 and S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 11, 12.

35 The website for Aviareto (which operates the electronic registry) is located at https://information.aero/international_registry_mobile_aircraft_assets (date of access: 14 May 2019). Aviareto was chosen by the International Civil Aviation Organization to manage the International Registry of Mobile Assets.

36 S van Erp 'The Cape Town Convention: a model for a European system of security interests registration?' (2014) 1 *Eur Rev Priv Law* 91 at 96, 97.

37 S van Erp 'The Cape Town Convention: a model for a European system of security interests registration?' (2014) 1 *Eur Rev Priv Law* 91 at 100.

38 Article 29(1) of the Cape Town Convention.

39 Article 19(2) of the Cape Town Convention.

provisions in the Convention itself are very general, and the separate Protocols contain the provisions, unique to the categories of assets, on how specific the asset description should be.[40]

The foundation for the enforcement regime under the CTC and the Protocols relies on freedom of contract (party autonomy).[41] The 'speedy relief' available in case of a pending action, arguably corresponds in most respects to the interim relief which applies in some domestic laws.[42] Under the CTC, a distinction is made between those remedies available to the lessor and the conditional seller (considered as owners of the object), and the secured creditor. The conditional seller and lessor already have ownership so the remedy available is to cancel the agreement and repossess or take control of the encumbered object.[43] The secured creditor can also take possession of the object and then either sell or lease the object. The CTC allows for self-help repossession, but a contracting state can opt-out of the application of this provision by making a declaration in terms of article 54(2).[44] The secured creditor may take possession of the object without having to send the debtor a notice of its intention to do so.[45] However, as the proposed disposition of the object (either a sale or leasing the object) will have an effect on interested parties, reasonable prior notice must be given to affected persons.[46] Any enforcement remedy must be exercised in a commercially reasonable manner.[47]

There are other unique features which form part of the provisions of the CTC and its Protocols, which will be referenced as part of the discussion concerning the soft-law instruments which inspire domestic secured transactions law reform.

3.2.2 Soft law and secured transactions law reform

The doctrinal definition of 'soft law' includes those non-binding rules or provisions of a normative nature which form part of a legal instrument and which are applied on a voluntary

40 Article 18(1) of the Cape Town Convention.
41 BP Honnebier 'The fully-computerized international registry for security interests in aircraft and Aircraft Protocol that will become effective toward the beginning of 2006' (2005) 70 *J Air L & Com* (2005) 63 at 76.
42 S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 12.
43 Article 10 of the Cape Town Convention.
44 South African has made an art 54(2) declaration. See https://www.unidroit.org/franchise-2nd-other-lang/141-instruments/security-interests/cape-town-convention-mobile-equipment-2001/depositary/declarations-by-article/446-article-54-2-declarations-deposited-under-the-cape-town-convention-on-international-interests-in-mobile-equipment (date of access: 28 May 2019).
45 S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 191,192.
46 Article 8(4) of the Cape Town Convention.
47 Article 8(3) of the Cape Town Convention.

basis.[48] Classic examples of soft-law instruments include model laws and legislative guides. Soft-law rules or provisions either impact on the reader's understanding of current binding legal rules, or form a promise, resulting in an expectation of specific future conduct.[49] Therefore, even though soft law is non-binding,[50] it influences a state's perception of what is meant by 'compliant legal rules' and thus what the 'law ought to look like'. In turn, this perception influences the key policy objectives and fundamental principles that a state might adopt when legal reform takes place. Consequently, the provisions in soft-law instruments become positive law to the extent that the country chooses to implement them as part of its domestic law.[51]

The relevant soft-law instruments when it comes to secured transactions law, all tend to subscribe to a basic philosophy of moving away from traditional policies and objectives that previously formed part of secured transactions law or property law, to respond effectively to a modern financial and commercial need.[52] In essence, soft law developed as a result of a commercial need.[53] Ultimately, the point behind producing a soft-law instrument is that these instruments offer advantages beyond those offered by hard-law instruments.[54] International organisations, such as UNCITRAL and the World Bank, and regional organisations, such as the Organization of American States (OAS) or regional development banks, like the European Bank for Reconstruction and Development (EBRD), play a key role in promulgating soft-law instruments related to secured transactions law.[55]

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48 HD Gabriel 'Towards universal principles: the use of non-binding principles in international commercial law' (2014) 17 *Int'l Trade & Bus L Rev* 241 at 242 and HD Gabriel 'The advantages of soft law in international commercial law: the role of UNIDROIT, UNCITRAL, and the Hague Conference' (2009) 34 *Brook J Int'l L* 655 at 658.

49 AT Guzman & TL Meyer 'International soft law' 2010 (2) 1 *J Legal Analysis* 171 at 174. See also HD Gabriel 'The advantages of soft law in international commercial law: the role of UNIDROIT, UNCITRAL, and the Hague Conference' (2009) 34 (3) *Brook J Int'L L* 655 at 658

50 HD Gabriel 'Towards universal principles: the use of non-binding principles in international commercial law' (2014) 17 *Int'l Trade & Bus L Rev* 241 at 242.

51 A Korzhevshaya 'Do we still need a convention in the field of harmonisation of the international commercial law?' 2014 *BRICS L J* 83 at 90 with reference to a model law, and HD Gabriel 'The advantages of soft law in international commercial law: the role of UNIDROIT, UNCITRAL, and the Hague Conference' (2009) 34 *Brook J Int'l L* 655 at 659.

52 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 128.

53 The *Lex Mercatoria* is arguably the most important source of soft law in international commercial law. See HD Gabriel 'Towards universal principles: the use of non-binding principles in international commercial law' (2014) 17 *Int'l Trade & Bus L Rev* 241 at 242.

54 HD Gabriel 'The advantages of soft law in international commercial law: the role of UNIDROIT, UNCITRAL, and the Hague Conference' (2009) 34 *Brook J Int'l L* 655 at 665.

55 A Korzhevshaya 'Do we still need a convention in the field of harmonisation of the international commercial law?' 2014 *BRICS L J* 83 at 83. See also HD Gabriel 'Towards universal principles: the use of non-binding principles in international commercial law' (2014) 17 *Int'l Trade & Bus L Rev* 241 at 244. See further, SV Bazinas 'The influence of the UNCITRAL Legislative Guide on Secured Transactions' in F Dahan (ed) *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 30

The flexibility associated with soft-law instruments is very advantageous for the law reform process. This flexibility promotes the relative ease with which normative provisions can be incorporated as part of domestic law. These instruments are also more easily incorporated as part domestic law in that they allow a country to select those provisions that address a particular legislative need in that reforming country. Having such flexibility inevitably leads to the best, and not merely the only, available outcome being considered and ultimately implemented as part of domestic law reform.[56]

The UNCITRAL Legislative Guide on Secured Transactions (the UNCITRAL Guide/ Guide) is arguably a 'successful soft law instrument'.[57] In this instance, legal reform suggestions, in the form of a legislative guide, were preferred over a Convention – a hard-law instrument.[58] This choice was based on the flexibility required to establish a *globally* recognised instrument on aspects of property law.[59] The Guide is a 'rich, elaborate and a pedagogically sophisticated' *normative* instrument.[60] The wider application of the UNCITRAL Guide is precisely due to its characterisation as a soft law instrument, which allows sufficient flexibility for countries when deciding how to implement its recommendations and the commentary linked to them.[61] Questions have been raised as to whether the Guide's flexibility potentially relegates the need for certainty under circumstances where third-party or public interest is also at stake.[62] However, the opposing view is that the recommendations, coupled with the commentary, provide sufficient certainty regardless of the flexibility of the Guide.[63] Flexibility does not necessarily mean an instrument is uncertain, but only that it creates

commenting on the 'track record of UNCITRAL' which adds to the authoritive nature of the UNITRAL Guide.

56 HD Gabriel 'Towards universal principles: the use of non-binding principles in international commercial law' (2014) 17 *Int'l Trade & Bus L Rev* 241 at 244, 257 and 249; M Lukas 'Attachment/creation of security interest' (2008) 5 *ECFR* 135 at 141. See G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 20-21 where the more flexible approach of a Model Law is preferred to the 'all or nothing' approach of a convention.

57 M Lukas 'Attachment/creation of security interest' (2008) 5 *ECFR* 135 at 141.

58 HD Gabriel 'Towards universal principles: the use of non-binding principles in international commercial law' (2014) 17 *Int'l Trade & Bus L Rev* 241 at 256. See also SV Bazinas 'The influence of the UNCITRAL Legislative Guide on secured transactions' in F Dahan (ed) *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 30. See also, G McCormack *The UNCITRAL Experience* (2011) at 20-27 on how instruments like Model Laws are more suited to achieve harmonisation and/or modernisation.

59 HD Gabriel 'Towards universal principles: the use of non-binding principles in international commercial law' (2014) 17 *Int'l Trade & Bus L Rev* 241 at 256.

60 RA Macdonald 'A model law on secured transactions. A representation of structure? An object of idealized imitation? A type, template or design?' (2010) 15 *Unif L Rev* 419 at 446.

61 See SV Bazinas 'The influence of the UNCITRAL Legislative Guide on Secured Transactions' in F Dahan (ed) *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 30 and 61.

62 A Korzhevshaya 'Do we still need a convention in the field of harmonisation of the international commercial law?' 2014 *BRICS L J* 83 at 95.

63 SV Bazinas 'The influence of the UNCITRAL Legislative Guide on secured transactions' in F Dahan (ed) *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 30.

different policy choices. Provided those policy options are adequately explained in the document, the risk of a lack of certainty is minimal. Still, a small risk of uncertainty when weighed against the potential impact of the flexibility resulting in an effective secured transactions law framework, looks like a fair trade-off. Also, a potential gap could be filled through the interpretation and then adaptation of existing domestic legal principles, which is exactly how domestic law reform should preferably occur.

The UNCITRAL Guide is the first soft-law instrument discussed, followed by a discussion of the UNCITRAL Model Law on Secured Transactions (the UNCITRAL Model Law).[64] The paragraph directly below provides a brief introductory background, followed by a discussion of the key policy objectives and fundamental principles central to the instruments, which also forms the common denominator which makes a functional comparison between secured transactions law frameworks possible in this thesis.

3.3 The UNCITRAL framework: the Legislative Guide and the Model Law

3.3.1 Background, purpose, and approach

UNCITRAL has drafted several prominent legal instruments related to secured transactions law.[65] The most influential is undoubtedly the UNCITRAL Legislative Guide on Secured Transactions and ancillary instruments.[66] The precursor to the idea of a legislative guide on secured transactions law was a comprehensive review of domestic and regional secured transactions law frameworks, prepared in 1977 by Professor Ulrich Drobnig.[67] However, the

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64 UNCITRAL Model Law on Secured Transactions (2016) available at http://www.uncitral.org/pdf/english/texts/security/ML_ST_E_ebook.pdf (date of access: 12 September 2018) (UNCITRAL Model Law).

65 UNCITRAL instruments relating to secured transactions law include: the United Nations Convention on the Assignment of Receivables in International Trade (2001) available at http://www.uncitral.org/pdf/english/texts/payments/receivables/ctc-assignment-convention-e.pdf (date of access: 11 November 2014) – the instrument has not yet entered into force. Also see the UNCITRAL Model Law on Secured Transactions: Guide to Enactment (2017) available at http://www.uncitral.org/pdf/english/texts/security/MLST_Guide_to_enactment_E.pdf (date of access: 12 September 2018).

66 The UNCITRAL Legislative Guide on Secured Transactions (2007) (UNCITRAL Guide) available at http://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf (date of access: 11 November 2014) (UNCITRAL Guide); the UNCITRAL Legislative Guide on Secured Transactions: Supplement on the Security Rights in Intellectual Property (2010) available at http://www.uncitral.org/pdf/english/texts/security-lg/e/10-57126_Ebook_Suppl_SR_IP.pdf (date of access: 11 November 2014); UNCITRAL Guide on the Implementation of a Security Registry (2013) available at http://www.uncitral.org/pdf/english/texts/security/Security-Rights-Registry-Guide-e.pdf. (date of access: 11 November 2014).

67 [1977] 8 UN Comm'n on Int'l Trade Law [UNCITRAL] YB 171, UN Doc A/CN.9/SER.A/1977. Also, see AH Raymond 'Cross-border secured transactions: ongoing issues and possible solutions' (2011) 87 *Elon*

findings of the report were not optimistic as to the possibility of providing a set of universally accepted international rules regulating security interests.[68] Accordingly, UNCITRAL regarded the unification of the law concerning security rights in movable property an unachievable goal.[69] However, some twenty years later in the late 1990s there was a resurgence of interest in the unification of secured transaction law which ultimately resulted in the adoption of the UN Convention on the Assignment of Receivables in International Trade of 2001.[70] The UN Commission then requested UNCITRAL Working Groups to develop general legal principles concerning security interests in 2001, and the result was the UNCITRAL Guide.[71] The UNCITRAL Guide was approved by the UN General Assembly on 11 December 2008. [72] Thereafter, the UNCITRAL Model Law was adopted in 2016,[73] followed by the acceptance of the UNCITRAL Model Law on Secured Transactions: Guide to Enactment (UNCITRAL Model Law: Guide to Enactment) in 2017.[74]

The purpose of the UNCITRAL Guide is to make recommendations which will allow a legal jurisdiction to 'establish a single comprehensive regime for secured transactions'.[75] This legal regime should be 'modern and efficient'.[76] Ultimately, the Guide is to serve as a 'template' for the future development of secured transactions law in general.[77] Indeed, the UNCITRAL Guide is credited with already having influenced reform in several countries.[78] Dirix eloquently summarises the purpose of the Belgian Pledge Act, which was drafted in line

Law Review 87 at 87; Akseli NO *Harmonised Law and Facilitation of Credit with Special Reference to the UNIDROIT Convention on International Factoring and the UNCITRAL Convention on the Assignment of Receivables in International Trade* (2006) (unpublished D Phil-thesis: University of Manchester) at 45-47; and G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 11-12. These contributions contain a brief summary of the history of the reform initiatives.

68 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 11.

69 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 12.

70 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 12.

71 See the instruction in Resolution of the United Nations Commission on International Trade Law and General Assembly resolution 63/121, included as Annex II to the UNCITRAL Guide.

72 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 13. For a discussion of the legislative process of the Guide, see NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 16.

73 See the Decision of the United Nations Commission on International Trade Law and General Assembly resolution 71/136, included as Annex I to the UNCITRAL Model Law on Secured Transactions: Guide to Enactment.

74 Decision of the United Nations Commission on International Trade Law and General Assembly resolution 71/136, included as Annex II to the UNCITRAL Model Law on Secured Transactions: Guide to Enactment.

75 The purpose statement in respect of Chapter 1 to the UNCITRAL Recommendations.

76 DP Stewart 'Private international law, the rule of law, and the economic development' (2011) 56 *Vill L Rev* 607 at 615.

77 HD Gabriel 'Towards universal principles: the use of non-binding principles in international commercial law' (2014) 17 *Int'l Trade & Bus L Rev* 241 at 257.

78 Australia: see R Patch 'Personal property securities reform in Australia' (2010) 15 *Unif L Rev* 459 at 462, and Belgium: see the Explanatory memorandum to the Belgium Pledge Act at 5 and E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 232.

with the general theme of the UNCITRAL Guide.[79] Firstly, the author describes the Belgian Pledge Act's approach as the simple and efficient creation of a security right (collectively referred to as a pledge). The approach of the Belgian Pledge Act allows parties to use a wide bouquet of assets as security. Further, it is possible to secure all types of obligation under the Belgian Pledge Act. The Act also removes the cumbersome requirement that the debtor should give up possession of collateral in exchange for funding. In general, the Belgian Pledge Act creates a system that is both consistent and integrated. Finally, the Belgian Act allows for efficient enforcement of the security right with limited court intervention.[80] Thus, the Belgian Pledge Act of 11 July 2013 embodies those features the UNCITRAL Guide recommends as forming part of a secured transactions law framework.

As in the UNCITRAL Guide, the UNCITRAL Model Law applies to contractually-created property rights. The general purpose of the Model Law is also to assist countries who intend to modernise their secured transactions law, with the focus being on security rights in movable property.[81] Some have questioned whether a model law is desirable or feasible.[82] Indeed, where each legal jurisdiction operates from different reform contexts, a single model law might not be suitable for reform in general, but there are legal jurisdictions that will benefit from a more prescriptive document which provides predictive legal text. Consequently, the Model Law's benefit lies in the higher level of uniformity of its framework compared to the Guide.[83] In general, model laws are regarded as suitable legal instruments for the modernisation and unification of national laws.[84]

Even though the Guide and Model Law follow the approach and mirror the norms of UCC Article 9 (eg, using a unitary concept of a security right),[85] the instruments are not carbon copies of UCC Article 9.[86] There is a discernible difference in key concepts, as is evident, for example, in the distinction between creation and third-party effectiveness under the

79 E Dirix 'The new Belgian Act on security rights in movable property' (2014) 23 *Int Insolv Rev* 171 at 175.

80 E Dirix 'The new Belgian Act on security interests in movable property' (2014) 23 *Int Insolv Rev* 171 at 175.

81 UNCITRAL Model Law: Guide to Enactment para 5 at 4.

82 RA Macdonald 'A Model Law on Secured Transactions. A representation of structure? An object of idealized imitation? A type, template or design? (2010) 15 *Unif L Rev* 419 at 421-423, 444.

83 UNCITRAL Model Law: Guide to Enactment para 11 at 6.

84 JAE Faria 'Future directions of legal harmonisation and law reform: stormy seas or prosperous voyage' (2009) 14 *Unif L Rev* 5 at 9.

85 U Drobnig 'Unified rules on proprietary security–in the world and in Europe' (2009) 85 *Bol Fac Direito U Coimbra* 667 at 678 and G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 182.

86 See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 19 where the author responds with reference to the Guide, to such critics by stating that 'this argument is fortuitous, as this claim lacks full theoretical and practical support.'

UNCITRAL instruments[87] when compared to the UCC Article 9 approach of attachment (making the security interest enforceable *inter partes* and to rank above specific unsecured creditors) and perfection (resulting in *erga omnes* enforceability).[88] Nevertheless, as under the UCC Article 9, the functional approach is entrenched in both UNCITRAL instruments.[89] Further, as emerges *infra*, the Guide takes an innovative approach to the acquisition finance devices.[90] In the case of acquisition finance, the UNCITRAL Guide allows both unitary and non-unitary approaches to acquisition finance as opposed to the exclusively unitary approach followed by UCC Article 9 and the UNCITRAL Model Law.[91]

As the UNCITRAL Guide is a normative instrument, the recommendations and commentary are not necessarily written in 'concrete legislative language', as is the case with the UNCITRAL Model Law.[92] Accordingly, the UNCITRAL Model Law is a more practical tool for legislators. In general, a model law is more context-driven and less policy-driven, reducing some of the flexibility available to lawmakers.[93] The UNCITRAL Model Law is a 'one-size-fits-all' approach as opposed to the more flexible nature of the UNCITRAL Guide. Nevertheless, both instruments share the normative foundation contained in the key policy objectives and fundamental principles.

The UNCITRAL instruments are set to rise above the conflict between provisions contained in diverse legal regimes by offering 'pragmatic and proven solutions' which all countries, both from a civil-law and common-law tradition, can incorporate into their domestic laws.[94] This attempt is particularly evident under the Guide. The Guide attempts to bridge this gap in two ways. First, it uses a comprehensive set of fundamental principles (policies),[95] normative in nature, as the basis for the drafting process.[96] These principles form the foundation of the Guide and are suited for use by different legal regimes (or traditions).[97] The Guide's

87 For the purposes of this thesis, UNCITRAL instruments are the UNCITRAL Guide and Model Law.

88 'Attachment' means that the security interest is created and becomes is *generally effective* against unsecured creditors. 'Perfection' makes the security interest effective against all third parties.

89 See recommendation 1 to the UNCITRAL Guide. Even though no article in the Model Law deals exclusively with the functional approach, it would be impossible for the Model Law to operate without using the functional approach, thus the approach is implied.

90 See paragraph 3.3.4 *infra*.

91 See paragraph 3.3.10 *infra*.

92 UNCITRAL Model Law: Guide to Enactment para 11 at 6.

93 RA Macdonald 'A model law on secured transactions: A representation of structure? An object of idealized imitation? A type, template or design? (2010) 15 *Unif L Rev* 419 at 427.

94 Introduction of the UNCITRAL Guide para 3. The reference to 'proven' arguably entails that the solutions were based on practical examples already implemented by some legal jurisdictions.

95 The concepts 'fundamental policies' or 'fundamental principles' are used interchangeably.

96 See paragraph 3.3.3 *infra* where these principles are discussed.

97 AH Raymond 'Cross-border secured transactions: ongoing issues and possible solutions' (2011) 87 *Elon Law Review* 87 at 91. Also see the opinion on the possible suitability of the Guide to many legal traditions

approach is unique, as it explores *policy* alternatives and elaborates on the logic behind each policy consideration. The extensive commentary, which clarifies how the fundamental principles fulfil the key policy objectives, expands on the logic behind the policy considerations.[98] The concrete language of the Model Law still allows countries that follow different legal traditions to implement the Model Law's provisions. According to the UNCITRAL Model Law: Guide to Enactment, the Model Law shares the Guide's key policy objectives and fundamental principles. Further, the UNCITRAL Model Law: Guide to Enactment (as an explanatory document to the Model Law), also expands on the logic behind the policy alternatives and elaborates on the logic behind each policy consideration associated with the Model Law.

The drafters of the Guide and Model Law had the challenging task of marrying the different terminology used in common-law and civil-law legal jurisdictions. The texts of the UNCITRAL instruments attempted to resolve this by not borrowing a term as it appears in any particular legal system – domestic or otherwise. The preferred option was rather to use an extensive glossary (under the Guide) and detailed definitions and rules of interpretation (under the Model Law) on what the term means specifically within the context of the UNCITRAL instruments. In summary, this means using a 'common vocabulary and conceptual framework'.[99] Consequently, the reader is able to identify a concept without preconceived ideas based on his or her knowledge of national law.[100] The neutral language adopted in the UNCITRAL instruments also makes it possible to adopt the functional approach to secured transactions law.

What follows is a discussion of which key policy objectives associated with an effective secured transaction law framework are envisaged under the Guide and Model Law. The discussion of the key objectives is followed by an analysis of how the fundamental principles appear in the Guide and the Model Law. As previously explained, the fundamental principles are used as the building blocks to achieve specific key objectives contained in the UNCITRAL instruments.

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expressed by RA Macdonald 'A Model Law on Secured Transactions: A representation of structure? An object of idealized imitation? A type, template or design? (2010) 15 *Unif L Rev* 419 at 442.

98 RA Macdonald 'A Model Law on Secured Transactions: A representation of structure? An object of idealized imitation? A type, template or design? (2010) 15 *Unif L Rev* 419 at 423.

99 Introduction of the UNCITRAL Guide para 15 at 4-5.

100 The bias of a comparative researcher is a threat to the outcome of any comparative study and using neutral foundation for the Guide's terminology assists to partially counter the bias.

3.3.2 Key policy objectives

The UNCITRAL Guide creates a broad and general *policy* framework for legislators.[101] The Guide distinguishes between key policy objectives and fundamental principles (policies).[102] The key policy objectives fit into an extensive policy framework,[103] which would form the foundation for domestic secured transactions law reform. The intention is that different key policy objectives will each speak to a 'specific practical or economic need'.[104] Consequently, the key policy objectives link to achieving legal efficiency (consisting of the legal functioning of laws and the economic benefit it brings).[105] In turn, the fundamental principles (policies) form the 'building blocks' required to realise the key policy objectives.[106] The Guide suggests that a country should avoid cherry-picking between the key policy objectives, but rather attempt, as far as possible, fully to consider and incorporate all the objectives.[107] However, the broader purpose of soft law – to use 'selective borrowing' of legal principles – informs the approach of which key policy objectives and fundamental principles that form part of the UNCITRAL instruments will be fit-to-context.

Even though the Model Law does not list its key policy objectives, both it and the Guide aim to achieve the same key policy objectives.[108] Consequently, as the UNCITRAL Model Law shares the key policy objectives and fundamental principles (policies) of the UNCITRAL Guide,[109] the duplication of provisions is inevitable.[110] Although the fundamental principles are the same, minor differences between the Guide and the Model Law in the implementation of the fundamental policies are highlighted in the discussion *infra*.

The goal is that the UNCITRAL Guide or the UNCITRAL Model Law serve as the foundation for domestic law reform and that the key policy objectives are included in the purpose statement of the newly-drafted national legislation.[111] What follows is a brief

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101 SV Bazinas 'The influence of the UNCITRAL Legislative Guide on Secured Transactions' in F Dahan (ed) *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 30.
102 Introduction to the UNCITRAL Guide para 46 at 19.
103 Introduction to the UNCITRAL Guide para 47 at 19.
104 Introduction to the UNCITRAL Guide para 48 at 20.
105 See Chapter 1 paragraph 1.2 *supra*.
106 See Chapter 1 paragraph 1.3 *supra* on the role of key policies and fundamental policies (principles).
107 Introduction to the UNCITRAL Guide para 48 at 20.
108 Chapter I of the UNCITRAL Model Law on Secured Transactions: Guide to Enactment para 16 at 7.
109 SV Bazinas 'The OAS and the UNCITRAL Model Laws on Secured Transactions compared' (2017) 22 *Unif L Rev* 914 at 916. Also see the UNCITRAL Model Law: Guide to Enactment paras 16, 17 at 7,8.
110 UNCITRAL Model Law: Guide to Enactment para 17 at 8.
111 Chapter I of the UNCITRAL Model Law on Secured Transactions: Guide to Enactment para 18 at 8.

discussion of the key policy objectives initially suggested by the Guide and incorporated as part of the Model Law.[112]

(a) The advancement of low-cost credit through increased availability of secured credit

The first objective involves the promotion of the availability of low-cost credit as a result of secured credit being more readily available.[113] The theory behind this objective is that where secured credit is readily available, the cost of credit goes down.[114] Also, where the secured transaction law framework is simple,[115] predictable,[116] and transparent,[117] a considerable reduction in the cost of credit takes place as a by-product, which is ultimately passed down to the debtor.[118] Reducing the cost of credit also has a direct impact on economic growth. The savings on the cost of credit are used to grow an entrepreneur's business while more entrepreneurs will also be able to access credit as a means to grow their businesses.

However, early indications from a country like Australia, which has fairly recently reformed its laws, show that the unitary system has resulted in an increase in the cost of credit.[119] It is, however, to be expected that the initial cost of implementing a new framework will increase the overall cost of credit, and so one should not be too hasty in drawing conclusions from these early indications from Australia.

(b) Debtors must be able to use the full inherent value locked in their assets as collateral

The second objective is to 'allow debtors to use the full value inherent in their assets to support credit'.[120] Unlocking the *full* value embedded in assets is key to an effective secured transactions framework. Often an application for credit is rejected as the bank is unable to find

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112 The alphabetic reference for this sequence, as opposed to numeric numbering, is used to correspond to the numbering in the Guide.

113 Recommendation 1(*a*) of the UNCITRAL Guide.

114 Introduction to the UNCITRAL Guide para 48 at 20. The basic theory of supply-and-demand.

115 'Simplicity' mostly relates to creation and enforcement of the security right.

116 An example is predictable priority rules. Where a creditor is clear on the priority it will obtain on default and later insolvency, it will grant credit on more favourable terms.

117 This would relate to efficacy of publicity of the security right and the certainty that there are no other security interests in an asset which allow the creditor to grant credit on more favourable terms.

118 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 45.

119 B Whittaker 'Review of the Personal Property Act 2009: Final Report' 27 February 2015 at 32, available at https://www.ag.gov.au/Consultations/Documents/PPSReview/ReviewofthePersonalProperty Securities Act2009FinalReport.pdf (date of access: 18 September 2018).

120 Recommendation 1(*b*) of the UNCITRAL Guide.

sufficient collateral to secure the debtor's loan. The refusal of the credit application does not necessarily mean that the debtor does not have adequate collateral. Rather, the problem is often that the current secured transactions law framework allows the debtor to use only a fraction of the value of her movable assets as security. When granting the loan, a financial institution will estimate how much of the value of the asset it will be able to recover if the debtor defaults. This estimate will influence the loan-to-value ratio that the institution applies in its assessments.[121] Financial institutions must continue to be competitive and to do so there must be sufficient and usable security available to mitigate the risks associated with advancing funds.[122] Having sufficient security to be able to cover the outstanding debt ultimately links to the legal function of a secured transactions law framework. However, it is unlikely that the Guide intended that the debtor should be able to achieve a loan-to-value percentage of 100 (meaning that the debtor should be able to use the entire value of the assets as security). The more likely reasoning is that the debtor must be able to use all *kinds* of asset so increasing the pool of assets available as collateral.

This key policy objective is regarded as possible to fulfil, where an integrated and functional approach is followed.[123] This is one of the fundamental principles discussed below. A fragmented framework in respect of security rights, arguably results in a scenario where the specific legal nature of that security device makes it impossible to use a particular type of asset as security. In many instances, this may have resulted in piecemeal law reform, which probably created a partiality for the use of specific types of assets as security,[124] as this is what is permitted under the current legal framework.

Another policy objective, achieving party autonomy, is also linked to the objective under discussion. Parties must not only have the freedom to choose the rules that apply to their secured transaction,[125] but should also be able to decide on the bouquet of assets that can secure the transaction.

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121 For example, where a business owner provides equipment as collateral valued at ZAR100, where the bank considering the risk of default uses a loan to value ratio of 50%, the debtor will use all of the equipment as security, but will only be able to obtain funding of ZAR50 from the financier.

122 Where the collateral is insufficient, financial institutions take security in another manner, for example by taking a profit share in the enterprise, which is not ideal for a small business owner who is now sharing its hard-earned wealth with the institution.

123 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 46.

124 An example is the special notarial bond under the South African SMPA which cannot be registered over incorporeal movable property, future assets, or revolving stock.

125 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 48.

To summarise: the categories of asset that can be taken as security need to be comprehensive, and the legal nature of the security device must allow most types of asset to be used as security.

(c) A simple yet effective way to create a security right

The parties must be able 'to create a security right in a simple and efficient manner'.[126] In most reformed legal jurisdictions, there is a clear distinction between the creation of the security right, application *inter partes*, and the establishment of third-party effectiveness.[127] The Guide and Model Law suggest a unique approach where the security right is created once the security agreement is concluded.

From the definition of a security right (discussed in greater detail *infra*), it is evident that a *property* right is created contractually under the UNCITRAL instruments. Third-party effectiveness then requires additional action. However, the security right is a right *in rem* from the moment it is created contractually. Thus, the secured creditor has recourse to the debtor's asset as soon as the debtor defaults. Nevertheless, it is possible for multiple security rights to exist in the same asset which means that more than one creditor has recourse to the debtor's asset. However, these unperfected security rights are unenforceable against the other secured creditors. This potentially problematic aspect is elaborated on further in the discussion of the fundamental principles *infra*.[128]

(d) Equal treatment of all types of creditor and diverse types of secured transaction

All types of credit provider, irrespective of the form of credit they provide, should receive equal treatment.[129] This means that private lenders and financial institutions should be treated equally and there are no security devices reserved exclusively for the use of financial institutions. There

126 Recommendation 1(*c*) of the UNCITRAL Guide. This is also a purpose of the Belgian Pledge Act of 11 July 2013. Further, this is one of the four objectives which, Dahan contends, will result in the adoption of a single framework for secured transactions. See F Dahan 'A single framework governing secured transactions' in F Dahan *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 67).

127 This is true of the UCC Article 9 (and other domestic jurisdictions which follow this approach), the UNCITRAL Guide, the UNCITRAL Model Law, the EBRD Model Law, and the OAS Model Law. In general, see NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 49.

128 See paragraph 3.3.3.5 *infra*.

129 Recommendation 1(*d*) of the UNCITRAL Guide.

is a valid reason for the stricter regulation of credit providers generally linked to consumer protection. It is, however, sound practice to include this objective, subject to incorporating adequate safeguards which protect consumers against unscrupulous credit providers.

To achieve this equal treatment, there must be no distinction – or as little distinction as possible – between the legal nature of a traditional security right and a *quasi*-security right (eg, rights under a retention-of-title and financial lease). The principle of equality cuts across all aspects of the existence of a security right, starting with the creation of the right and ending with enforcement measures available to a secured creditor.

(e) Providing a non-possessory security right in all types of asset

Most reform initiatives revolve around the availability of an effective non-possessory security device. The objective is that non-possessory security right should extend to *all* types of asset,[130] both tangible and intangible.[131] The benefits in including a non-possessory security right are summarised as the following: (1) resolving the issue with the traditional pledge where the debtor needs to relinquish possession of the encumbered asset; (2) a security right in a future asset becomes a possibility; and (3) allowing a creditor to use a single security device to create a security interest in both tangible (specifically, inventory and equipment) and intangible (which should include receivables) movable property.[132]

(f) The framework must achieve certainty and transparency: having a general security registry

Improved certainty and transparency[133] are, in the main, achieved through the registration of a notice in a general security rights registry.[134] Public notice of the security right makes third-party effectiveness more predictable and certain. Registration possibly also results in less effort

130 Recommendation 1(*e*) of the UNCITRAL Guide.

131 Also referred to as corporeal or incorporeal in some legal frameworks. These terms are used interchangeably in this thesis.

132 Introduction to the UNCITRAL Guide para 53 at 21.

133 Transparency is one of the fundamental principles of property law along with the *numerus clausus* principle. See Chapter 2 paragraphs 2.3.3.1 and 2.3.3.2 *supra*.

134 Recommendation 1(*f*) of the UNCITRAL Guide. 'Transparency and fairness' are linked as objectives that will lead to a single framework. See F Dahan 'A single framework governing secured transactions' in F Dahan *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 68.

and expense for creditors.[135] Parties must be able to establish with a reasonable level of certainty, the scope of the debtor's rights and those of third parties in assets to be encumbered. Nevertheless, there must be a balance between the registry containing sufficient information and not creating a cumbersome process of document registration (or transaction filing)[136] or infringing on the confidential nature of transactions.[137] Accordingly, modern secured transactions law uses the principle of 'functional notice'.[138] In this regard, the function of the notice is to provide third parties with public notice that property of a debtor is, or could be, collateral securing a debt. Put simply: the searcher is placed 'on notice' that a possible security right exists in a specific asset.

(g) Priority rules must be certain and clear

The claims of secured creditors might compete with other secured claims. Accordingly, 'clear and predictable priority rules' are recommended[139] – a creditor will only be able to prepare an effective risk-assessment if there are clear and predictable priority rules in place which allow her to know exactly where she stands in relation to other creditors. Determining priority where a unitary concept applies, would arguably be simpler and more certain than a system which uses different security devices. Predictable priority rules are possible where the provisions prescribing the method of third-party effectiveness are equally clear.[140] Public knowledge of the existence of a security right is linked to effective priority rules – the application of the publicity principle. The assumption is that where the security right is made public, it should be easier to determine priority ranking. A creditor must already know, at the moment it extends credit, what its priority position will be both when the debtor is solvent and insolvent.[141] This applies equally to priority rules dealing with future assets. Under the Guide, the priority of non-

135 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 51.

136 Transaction filing includes information on the security interest (right) and the security device used, and coincides with the filing of a complete document. See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 178. Belgium opted for transaction filing under its reformed framework. See E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 247.

137 Introduction to the UNCITRAL Guide para 54 at 21. The Australian Protection of Personal Securities Act 130 of 2009 (Australian PPSA) contains privacy provisions (s 173).

138 B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 99 and B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 252, 253.

139 Recommendation 1(*g*) of the UNCITRAL Guide.

140 Introduction to the UNCITRAL Guide para 55 at 21.

141 This will enable a creditor to conduct proper due diligence before the credit is extended. There is no obligation to compel due diligence under the Guide as is the case under UCC Article 9.

acquisition secured creditors is determined through the principle of first-to-register, while the priority of a possessory security right is based on the date of third-party effectiveness.

Traditionally, different priority rules may apply to title-based security devices depending on whether one is dealing with sellers or lenders. This difference in treatment stems from a seller using a reservation-of-ownership to secure a loan. However, the Guide aims to treat all acquisition finance providers equally by introducing the alternatives of either a unitary or non-unitary approach when it comes to acquisition finance.[142]

There is a clear distinction between the regular priority afforded to non-acquisition security rights holders, and the super-priority afforded the holder of an acquisition security right. The UNCITRAL instruments, therefore, make a policy choice to create an exception to the general rules that determine priority ranking. However, the Guide and Model Law attempt to maintain the balance between the rights of different creditors and the super-priority afforded the holder of the acquisition security right. Both the Guide and the Model Law provide drafting alternatives in respect of the extension of the acquisition security right to proceeds. The first option allows extension of the super-priority of the acquisition security interest to proceeds only in respect of identifiable cash proceeds (which is also the approach under UCC Article 9). The alternative option allows extension of the super-priority to other types of proceeds (eg, receivables) but subject to compliance with specific requirements (eg, advanced notice). The point is that regardless of the alternative chosen, the rules in respect of the different alternatives are clear. This distinction is discussed *infra*.[143]

(h) Promoting efficient enforcement of secured creditor's rights

In general, the Guide recommends that an enforcement right must be exercised 'in good faith and in a commercially reasonable manner',[144] and this is taken up by the Model Law as a general standard of conduct applicable to all its provisions.[145]

The framework must facilitate the efficient enforcement of the secured creditor's rights.[146] An effective secured transaction regime has 'efficient, economical and predictable

142 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 53.
143 See paragraph 3.3.4 *infra*.
144 Recommendation 131 of the UNCITRAL Guide.
145 Article 4 of the UNCITRAL Model Law. These general standards are also included in s 35 of the Nigerian Secured Transactions in Movable Assets Act 3 of 2017 (Nigerian Secured Transactions Act).
146 Recommendation 1(*h*) of the UNCITRAL Guide.

procedural and substantive rules' when it comes to the enforcement of security rights.[147] In simple terms, this means that: (1) all the parties involved know what their rights and obligation in respect of the enforcement measures are (the procedural and substantive rules are clear), and strive to comply with these rights and obligations; (2) the enforcement process is quick and cost effective (which implies the need to allow extrajudicial enforcement); and (3) ultimately, the creditor is able either to obtain the maximum value for the asset when it is sold, or must have means other than the sale of the asset, by which to recover the outstanding debt (eg, taking over the asset or leasing the asset to a third party).

Enforcement can be either judicial, extrajudicial,[148] or a streamlined (or expedited) judicial approach.[149] The expedited judicial approach possibly extends to either giving a party a limited time within which to raise a defence or lodge a counter-claim, or, more practically, carving-out specific cost provisions to deter parties from delaying the proceedings.[150] The creditor must also be able to use different enforcement approaches depending on what is best suited to the circumstances. The Guide and Model Law further recommend that creditors be allowed to use both their judicial and extrajudicial remedies.[151] This means that even where the creditor, for example, takes the extrajudicial route, she can decide to change her approach and institute judicial proceedings when she realises that the extrajudicial route is not going to deliver the desired outcome.

The enforcement measures must, of course, also be in line with the insolvency regime of the relevant country, and pre-insolvency rules should be very similar or, where possible, the same as the rules followed during insolvency proceedings.[152]

(i) Party autonomy

147 Chapter VIII of the UNCITRAL Guide para 6 at 276.

148 'Extrajudicial' relates to enforcement procedures without court intervention. It is also referred to as a 'voluntary' enforcement process. See AM Garro 'The OAS-sponsored Model Law on Secured Transactions: gestation and implementation' (2010) 15 *Unif L Rev* 391 at 410. 'Voluntary' entails that, in keeping with the principle of party autonomy, parties can agree on the steps they wish to follow during enforcement. Extrajudicial enforcement is discussed in paragraph 3.3.3.10 *infra*.

149 Recommendation 138 of the UNCITRAL Guide. Some recently reformed legal jurisdictions have opted for a measure of court intervention, but emphasise that this intervention should be as little as possible (eg, this is also a purpose of the Belgian Pledge Act of 11 July 2013).

150 Chapter VIII of the UNCITRAL Guide para 19 at 280.

151 Recommendation 143 of the UNCITRAL Guide.

152 Introduction to the UNCITRAL Guide para 56 at 21.

This objective entails that parties must have 'maximum flexibility to negotiate' the content of the security agreement to meet their individual commercial purpose.[153] The terms of the security agreement must be 'fit-to-context' as intended by the parties.[154] This does not mean that parties can include whatever they wish in the security agreement; and where the provisions of the agreement influence third-party rights, there must be mandatory rules limiting party autonomy. These limitations are subject to the provisions of domestic law.[155] The mandatory rules will add predictability and certainty regarding the types of right and obligation arising from the provisions of the security agreement. The Guide and Model allow deviation from the mandatory rules, but the deviation only applies *inter partes.*[156]

Party autonomy arguably conflicts with the *numerus clausus* principle observed, in the main, in civil-law jurisdictions.[157] It also implies a relaxation of the divide between property law and contract law. However, the extent of party autonomy and mandatory rules prescribed to limit its application should be managed so as to create the appropriate balance

(j) Balancing the interests of persons affected by the secured transaction

The Guide, and by implication the Model Law too, has the difficult aim of attempting 'to balance the interests of persons affected by a secured transaction'.[158] This objective appears more achievable where only the *legitimate* interests of all affected parties are considered. It can be achieved where similar rules are applied consistently to similar transactions and the parties involved are *comparable*. Having individually carved-out rules apply to a single secured transaction would defeat the entire purpose of the Guide. The ideal of equal treatment is arguably only achievable, in practical terms, by using a functional approach to secured transactions law.[159]

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153 Recommendation 1(*i*) of the UNCITRAL Guide. Also see, Introduction to the UNCITRAL Guide, para 57 at 21 and 22 and Chapter 1 of the UNCITRAL Guide para 115 at 59. This is also one of the four objectives which Dahan argues will result in the adoption of a single framework for secured transactions. See F Dahan 'A single framework governing secured transactions' in F Dahan *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 67).

154 See Chapter 1 paragraph 1.2 *supra* for the meaning of 'fit-to-context'.

155 Chapter I of the UNCITRAL Guide para 117 at 59. An example of a valid limitation would be consumer laws and the principles of law of contract of that legal jurisdiction.

156 Article 3(2) of the UNCITRAL Model Law.

157 See Chapter 2 paragraph 2.3.3.2 *supra* where this principle is explained.

158 Recommendation 1(*j*) of the UNCITRAL Guide.

159 SV Bazinas 'Acquisition financing under the UNCITRAL Legislative Guide on Secured Transactions' (2011) 16 *Unif L Rev* 483 at 502.

(k) Harmonisation

As with most international, and even regional, legal instruments, harmonisation is also an objective of the Guide and includes providing predictable conflict-of-laws rules.[160] Harmonisation within the context of the Guide entails that it will be mutually beneficial for states to align their secured transactions law regime with that of their trading partners (other states). However, where this is not possible, there must be clear conflict-of-laws rules so that it is always clear which law applies, irrespective of where the debtor resides or the asset is situated. As this study concerns modernisation, it is submitted that modernisation will tend to result in harmonisation.

What follows is a discussion of the fundamental principles (policies) that must be included in a legal framework to achieve the key objectives explained *supra*.

3.3.3 Fundamental principles (policies)

The Working Groups which drafted the UNCITRAL Guide intended that countries should agree on the key policy objectives as a basis, and then carve out alternative options reflecting those fundamental principles that will be used to achieve the key policy objectives of the legal reform.[161] There are twelve fundamental principles under the Guide which establish the 'link between the key policy objectives and the recommendations'.[162] As emerges from the discussion *infra*, these principles are intertwined with the recommendations and commentary to the Guide. In broad terms, the fundamental principles relate to the 'creation, third-party effectiveness, priority, and enforcement' of security rights. The discussion of the fundamental principles below is expanded to include a synopsis of how the recommendations and commentary incorporate the fundamental principles. It must be borne in mind when reading the discussion of the recommendations to the UNCITRAL Guide *infra*, that this is not adopted law *per se*, but the legal principles remain suggestions on potential law reform. However, the language used in the Model Law is more concrete and couched in legislative terms.

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160 Recommendation 1(*k*) of the UNCITRAL Guide and the Introduction to the UNCITRAL Guide para 59 at 22.

161 A good example is the choice between a unitary or non-unitary approach to acquisition finance.

162 SV Bazinas 'Key objectives and fundamental principles of the UNCITRAL Legislative Guide on Secured Transactions' (2008) 1 *Insolvency Restructuring International* 42 at 45.

The fundamental principles of the Model Law are the same as those implemented under the Guide.[163] Nevertheless, in a few instances, the Model Law follows a different approach to realise a specific fundamental principle. The difference in approach will become clear through the discussion *infra*.

3.3.3.1 Comprehensive scope: assets, type of security device, obligations, and transactions

The comprehensive nature of the UNCITRAL Guide ensures increased flexibility, balanced against the certainty created by the detailed commentaries to the recommendations. Commerce develops so rapidly that neither legislators nor courts can develop the law to keep pace.[164] According to Bazinas, the comprehensive scope of the Guide resolves this legislative timing issue, where a broad policy framework rather than detailed rules, allows greater legislative flexibility.[165] Generally, the UNCITRAL Model Law follows the same comprehensive scope as the Guide, with some minor differences in the scope of the two instruments highlighted *infra*.[166]

The Guide provides five factors against which to measure the scope of a secured transaction[167] – the same factors apply to the scope of the Model Law. These factors include: (1) the types of asset that may be used as security; (2) the types of party that may take part in a transaction; (3) the nature of the obligation the security right may secure; (4) the type of legal transaction from which the obligation flows; and (5) the extent to which the security right extends to the proceeds resulting from the encumbered property.

The discussion in this subparagraph is organised using the first four factors, with the discussion concerning proceeds reserved for a separate heading *infra*. What follows is a discussion of how these factors are intertwined in the recommendations and commentary of the Guide and the articles of the Model Law.

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163 Chapter I of the UNCITRAL Model Law on Secured Transactions: Guide to Enactment para 17 at 8.

164 For example, in the South African chapter a discussion is included on the 'clumsy' way in which non-possessory security devices were introduced after a court decision effectively casting the credit landscape into turmoil. See Chapter 2 paragraph 2.5.3 *supra*.

165 SV Bazinas 'Key objectives and fundamental principles of the UNCITRAL Legislative Guide on Secured Transactions' (2008) 1 *Insolvency and Restructuring International* 42 at 45.

166 Chapter I of the UNCITRAL Model Law: Guide to Enactment para 22 at 11.

167 Chapter I of the UNCITRAL Guide para 4 at 32.

(a) Type of assets over which a security right may or may not extend: included and excluded assets

It should be possible to take security in almost any type of movable property, including but not limited to, goods, equipment inventory (so excluding high-value mobile equipment for the purposes of the UNCITRAL instruments), receivables, letters of credit, bank accounts, negotiable instruments,[168] negotiable documents, and intellectual property. An examination of the type of assets over which a security right may exist, includes the following: (1) whether the instruments specifically exclude certain types of asset (eg, indirectly-held securities); (2) whether all types of tangible and intangible asset are included under the framework (eg, whether all type of receivables are included); (3) whether future assets can be included; (4) whether all or only specific types of proceed will be included; (5) whether, and the extent to which, the security right extends to a mass or product; and (6) whether, and the extent to which, the security right continues to exist where encumbered movable property is attached to immovable property. These considerations are explored further *infra*. Separate headings are devoted to the discussion in respect of proceeds and future assets.

The Guide and Model Law both recommend that any type of asset should be included,[169] unless the instrument explicitly excludes a type of asset for a practical reason (eg, the limitations of scope included in recommendation 4 to the Guide and article 1(3) of the Model Law). Accordingly, the discussion is structured to state the assets specifically included and then indicate which assets are specifically excluded (and provide some reasons for the exclusion). Two recommendations to the Guide are relevant in respect to the general scope of assets: recommendation 2 (scope of application of the Guide); and recommendation 17 (assets subject to a security right). In terms of recommendation 2(*a*) concerning the scope of application of the Guide, a security right may be created in:

> '…all types of movable asset, tangible or intangible, present or future, including inventory, equipment and other tangible assets, contractual and non-contractual receivables, contractual non-monetary claims, negotiable instruments, negotiable documents, rights to payment of funds credited to a bank account, rights to receive the proceeds under an independent undertaking and intellectual property;'

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168 The Guide distinguishes between a 'negotiable document' and a 'negotiable instrument' A negotiable document is a document which embodies a right to the delivery of a tangible asset (eg, a warehouse receipt). *Contra*, a negotiable instrument would be an instrument that embodies a right to payment subject to fulfilment of the requirements for negotiability.

169 Articles 1(1) and 8(*a*) of UNCITRAL Model Law and recommendation 2 of the UNCITRAL Guide.

Recommendation 17 to the Guide includes the general recommendation on the types of movable property a security right should be permitted to encumber. The range of assets is wide and includes any asset type, including parts of the assets and undivided rights in the assets, future assets, and 'all assets of a grantor'.[170] Article 8 of the UNCITRAL Model Law is based on recommendation 17 of the Guide. Article 8 is more to the point, and the following assets may be encumbered: (1) any type of movable asset (same as the Guide); (2) parts of the assets and undivided rights in the assets (same as the Guide); (3) a generic category of movable assets (this is not included in the Guide and potentially relates to encumbering an economic entity such as stock-in-trade); and all of the movable assets of the grantor (same as the Guide). There is no direct provision related to the creation of a security right in the entire business (or enterprise) of the debtor. Nevertheless, both the UNCITRAL Guide and the Model Law include the possibility of encumbering all of the debtor's assets under the concept of an 'all-asset security right'.[171] The function of an 'all-asset security right' is comparable to a floating charge or an enterprise charge.[172] But unlike the floating charge, this provision in the Guide does not allow for 'a carve-out in favour of unsecured creditors'. This means that at default or insolvency, all the debtor's assets are used to extinguish the debt of the secured creditor. Also, it is recommended that it must be possible for the debtor to dispose of assets 'in the ordinary course of its business'.[173]

The Guide and the Model Law recommend excluding specific types of asset from the extensive scope of assets listed above, under recommendation 4 of the Guide and article 1(3), (4), (5) of the Model Law.[174] Recommendation 4 to the UNCITRAL Guide recommends excluding the following movable property from its scope: (1) certain mobile equipment, either subject to national law or to an international agreement to which the enacting state is a party (accordingly, assets subject to specialised or industry-specific legislation);[175] (2) the Guide only applies to security rights in intellectual property as long as it is not inconsistent with either

170 This is also the case under art 8(*a*) and (*b*) of the UNCITRAL Model Law.
171 Recommendation 17 of the UNCITRAL Guide and art 8(*d*) of the UNCITRAL Model Law.
172 See the discussion of the enterprise charge under the EBRD Model Law in Chapter 3 paragraph 4.2.3.2(*i*) *infra*.
173 Chapter II of the UNCITRAL Guide para 70 at 83.
174 Recommendation 4 of the UNCITRAL Guide (which is more detailed than the Model Law provision) and art 1(3) of the UNCITRAL Model Law.
175 Recommendation 4(*a*) of the UNCITRAL Guide. The recommendation lists aircraft assets, railway rolling stock, space objects, ships, and other similar categories of mobile equipment. An example of such an international convention is the Cape Town Convention.

the national laws of a country or other treaty obligations;[176] (3) directly- or indirectly-held securities are regrettably excluded (the Model Law excludes only intermediated securities);[177] and payment rights arising either from financial contracts or foreign exchange transactions.[178] In terms of article 1(3), the Model Law will not apply to: (1) the right to request payment or receive proceeds from an independent guarantee or a letter of credit (which is not excluded under the Guide);[179] (2) intellectual property (also excluded under the Guide); (3) intermediated securities (the Guide excludes *all* securities);[180] (4) payment rights which arose under or as a result of financial contracts regulated by netting agreements (also excluded under the Guide);[181] or (5) assets subject to laws concerning either specialised secured transactions or specific asset-based registration (which is a broader provision than that in the Guide).[182] The exclusion of the movable assets mentioned above is, by and large, a result of the complexity of the legal principles relating to these assets.

Neither the Guide nor the Model Law applies to 'consumer goods'. Article 1(5) of the Model Law aims to preserve consumer-protection law to the extent that the Model Law does not disturb the rights and obligations under laws 'governing the protection of parties to transactions made for *personal, family and household purposes*' (emphasis added). The subparagraph does not use the term 'consumer goods', but the italicised words above complies with the definition of consumer goods – goods primarily used for personal, family or household purposes – as contained in article 2(*f*) of the Model Law.[183] Similarly, according to the Guide a security right should not affect rights under consumer-protection legislation.[184]

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176 Recommendation 4(*b*) of the UNCITRAL Guide. Also, the UNCITRAL Legislative Guide on Secured Transactions: Supplement on Security Rights in Intellectual Property, deals separately with intellectual property.

177 Chapter I of the UNCITRAL Guide para 39 and recommendation 4(*c*) of the UNCITRAL Guide. The exclusion is regrettable as this type of asset that plays a pivotal role in modern commerce. See RM Kohn 'The case for including directly held securities within the scope of the UNCITRAL Legislative Guide on Secured Transactions' (2010) 15 *Unif L Rev* 413 at 413-418.

178 Recommendations 4(*d*) and 4(*e*) of the UNCITRAL Guide.

179 Unlike the Guide, the security rights in the right to receive and the right to request payment under an independent guarantee or letter of credit, is excluded to avoid rendering the Model Law too complex

180 The reason for the difference between the Guide and Model Law is that non-intermediated securities often form part of finance transactions. See Chapter 1 of the UNCITRAL Model Law: Guide to Enactment para 26 at 12.

181 Due to the complexity, payment rights under or resulting from financial contracts governed by netting agreements, are also excluded from the Model Law's scope.

182 Listing specific types of asset inadvertently creates the potential for legislative gaps and the Model Law-approach is preferred. See Chapter 1 of the UNCITRAL Model Law: Guide to Enactment para 28 at 13.

183 'Primarily' is not used in the UNCITRAL Guide. The purpose of adding it to the Model Law was to draw a clear distinction between consumer and other goods. See UNCITRAL Model Law: Guide to Enactment para 42 at 17.

184 Recommendation 2(*b*) of the UNCITRAL Guide.

(b) Assignment of receivables

Receivables financing (using book debts) is often used to raise funds to finance a business.[185] Receivable financing is achieved either: (1) through an outright sale of the receivables at a discount (a person buys the debtors book at an agreed, potentially discounted price), of which factoring and securitisation are examples;[186] or (2) receivables are used to secure a loan (thus security transfer).[187] The Guide and Model Law apply to outright transfers of receivables by agreement, even though this type of transfer would not secure the payment or performance of an obligation (it is not a security device).[188] Thus, the Guide and Model Law frameworks allow both categories of receivables financing mentioned *supra*.[189]

Under the UNCITRAL framework, a receivable is 'a right to payment of a monetary obligation'.[190] However, this excludes a right to payment evidenced in a negotiable instrument, a right to the proceeds under an independent undertaking or a right to payment of funds credited to a bank account.[191] The Model Law also adds a 'right to payment under a non-intermediated security' to the excluded payments already contained under the Guide.[192] The UNCITRAL framework extends to: (1) contractual receivables (eg, the right of a lender to payment of a loan); (2) non-contractual receivables (eg, the right of a person to claim payment of damages as a result of harm suffered); and (3) future receivables.[193] Also, under the UNCITRAL framework, a security right in specific types of receivables (only trade receivables)[194] is effective regardless of a non-assignment clause.[195] Trade receivables in this context include:[196] (1) receivables which arose from a contract for the supply or lease of goods services (excluding a financial services, a construction contract, or a transaction concerning immovable property); a receivable which resulted from a contract where industrial or other intellectual property or

185 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 28-31 and the Introduction to the UNCITRAL Guide paras 28-30 at 15.
186 Introduction of the UNCITRAL Guide paras 31-34 at 16 (explaining factoring) and paras 35-37 at 16, 17 (explaining securitisation).
187 H Beale *et al The Law of Security and Title-based Financing* (3rd ed 2018) at 317 and NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 28.
188 Article 1(2) of the UNCITRAL Model Law and recommendation 3 of the UNCITRAL Guide. Thus, the equivalent of out-and-out cession under South African law. See Chapter 2 paragraph 2.4.6 *infra*.
189 Recommendation 3 of the UNCITRAL Guide and art 1(2) of the UNCITRAL Model Law.
190 Introduction of the UNCITRAL Guide at 12.
191 Introduction of the UNCITRAL Guide at 12 where the definition of a receivable excludes specific payments from the definition of a receivable.
192 Article 2(*dd*) of the UNCITRAL Model Law.
193 Chapter I of the UNCITRAL Model Law: Guide to Enactment para 62 at 23.
194 Chapter II of the UNCITRAL Model Law: Guide to Enactment para 113 at 39.
195 Article 13(1) of the UNCITRAL Model Law and recommendation 24(*a*) of the UNCITRAL Guide.
196 Article 3(*a*)-(*d*) of the UNCITRAL Model Law and recommendation 24(*c*)(i)-(iv).

proprietary information was sold, leased, or licensed; (3) a receivable arising from a payment obligation under a credit card transaction; and (4) a receivable arising from the settlement of payments which were due in respect of netting agreement where there are more than two parties.

(c) Security right extended to a mass, product, or an attachment

The Guide and Model Law make novel recommendations in respect of extending a security right into a mass, a product, or to an attachment (or fixture). Under domestic law, different terminology is possibly used. Attachment is referred to as accession, *specificatio* or 'the working up of a thing' refers to a 'product', and the reference to a 'mass' is either applicable in case of the mixing of solids (*commixtio*) or the mixing of liquids (*confusio*).[197]

Recommendation 22 of the Guide and article 11 of the Model Law provide guidance in these circumstances. The Guide stipulates a combined definition that extends to both a mass and a product. Conversely, the Model Law defines a product and a mass separately. According to the Guide, a mass or product refers to 'tangible assets other than money that are so physically associated or united with other tangible assets that they have *lost their separate identity*' (emphasis added).[198] The loss of the separate identity is what distinguishes the asset forming part of a mass or product, from an 'attached movable property' – the latter does not lose its separate identity. To avoid the debate surrounding commingled goods that are no longer individually identifiable, the Guide's approach is to assign a pro-rata value to the security right that the creditor had in the pre-commingled or pre-manufactured asset. The creditor will then have a security right equal to the value of the security right in the pre-commingled or pre-manufactured asset. This 'new' security right is, presumably, extended to the commingled asset or product, but with the priority ranking determined by reference to the ranking of the security right in the pre-commingled or pre-manufactured asset.

Other than the combined definition under the UNCITRAL Guide, article 2 of the Model Law contains separate definitions for the concepts 'a mass' and 'a product'. In the Model Law 'mass' means 'a tangible asset which results when a tangible asset is so *commingled* with one

197 See Chapter 2 paragraph 2.5.4.4 *infra*.

198 This definition is general enough to extend to both a mass and a product. Nevertheless, the more specific definitions in respect of a mass (which includes reference to 'commingling') and product (with reference to 'manufactured, assembled, or processed'), is preferred.

or more other tangible assets of the same kind that they have *lost their separate identities*' (emphasis added) In turn, a 'product' means

> 'a tangible asset which results when a tangible asset is so physically associated or united with one or more other tangible assets of a different kind, or when one or more tangible assets are so *manufactured, assembled or processed*, that they have *lost their separate identities'* (emphasis added).

Consequently, article 11 of the Model Law deals with assets that have been commingled in a mass or transformed into a product, and it is irrelevant whether or not the original tangible object is still identifiable. The security right now extends to either the mass or the product, but subject to certain limitations. In the case of a mass, the security right only extends to the proportion of the mass which the pre-commingled asset bore in respect to the commingled asset immediately after commingling has taken place (which differs from the approach under the Guide). As regards a product, the security right extends to the value of the encumbered asset before it became part of the product (this is also the position under the Guide).

In the case of a newly-manufactured product, the new product is a 'replacement' of the original encumbered asset. Technically, the security right is no longer in the original asset, and thus it is swapped for a security right, albeit limited to a mass or value, respectively, in the new commingled or produced property. Nevertheless, the priority of the 'new security right' is established with reference to the priority of the 'old security right', but limited to the value of the original component and also only applicable between the secured creditors with a security right in the original encumbered asset.

The Guide distinguishes between attachment of assets to either movable or immovable property – but attachment to immovable property is the more contentious of the two. 'Attachment to immovable property' generally means that the encumbered movable asset is physically attached to immovable property (referred to as accession). Typically, 'attachment' results in movable property being reclassified as immovable property under domestic law. In terms of recommendation 21 of the Guide, legislation should provide that it is possible either: (1) to create a security right in a movable object already attached to immovable property; or (2) that a security right which existed in the movable property when attachment took place, continues to exist after attachment.[199]

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[199] The Belgian Pledge Act of 11 of July 2013 also contains a provision where the pledgee's right to proceeds is not affected by the attachment. See s 19 'onroerendmaking'.

The Guide, however, appears to bypass the question of how to classify the attached property. Accordingly, the security right continues to exist in the attached property regardless of whether it is now characterised as movable or immovable. However, the description of an 'attachment' under the Guide refers to an attachment that remains 'identifiable'. In most cases of attachment, although the movable property remains identifiable, after attachment it can no longer be separated from the immovable property. It is submitted that the preferred approach is for the security right to exist in the immovable property after attachment, and also for that right to be registered in the immovable property register. Under the Guide, a security right in the attached movable property registered in the immovable registry, will also be effective against third parties. Conversely, the Model Law has no express provision dealing with security rights in attachments to movable or immovable property.[200] This is because the general property law rules which apply to the attachments to the movable property, are assumed to be adequate and applying the Model Law to immovable property will interfere with domestic law concerning immovable property.

(d) Specificity in respect of asset description

The provisions of both the Guide and the Model Law dealing with asset description, allow for a description that is more general when compared to some national laws which apply the principle of specificity more stringently.[201] Recommendation 14(*d*) of the Guide and article 9 of the Model Law set out the method recommended in describing the encumbered assets as part of the security agreement in a 'manner that reasonably allows their identification'. However, in terms of article 9(1) of the Model Law, this standard applies equally to the asset *and* the secured obligation; under the Guide, the obligation need only be 'described' and no mention is made to the standard of description required.

It appears that compliance with the asset-description requirement is determined on an *ad hoc* basis by considering the nature of the asset and the specific circumstances (most importantly, whether the description is specific or generic).[202] However, allowing a generic

200 SV Bazinas 'The UNCITRAL Model Law on Secured Transactions' in SV Bazinas & NO Akseli (eds) *International and Comparative Secured Transactions Law: Essays in honour of Roderick A Macdonald* (2017) at 58.

201 For example, the specificity requirement in terms of the South African SMPA. See Chapter 2 at paragraph 2.5.4.2 *infra*.

202 UNCITRAL Registry Guide para 190 at 77. See also the discussion in SV 'The UNCITRAL Model Law on Secured Transactions' in SV Bazinas & NO Akseli (eds) *International and Comparative Secured Transactions Law: Essays in honour of Roderick A Macdonald* (2017) at 62.

asset description potentially allows too much scope for judicial interpretation. 'Reasonably', in itself, does not provide sufficiently precise criteria as to what type of description will suffice. Nevertheless, allowing the nature of the encumbered asset to influence whether the description must be specific or more generic, is arguably the correct approach. Where it is possible to identify an asset in terms of an objective standard, a country should require that an objective standard form part of the required asset description.[203] The approach by some Personal Property Security Act (PPSA) regimes to prescribe categories of asset in the description, is probably to be preferred to the overly general asset description required in the Guide. However, in these circumstances too, the nature of the asset also determines whether an objective standard – eg, using an alphanumerical number – is at all possible.

Under the Model Law, a general description of the encumbered assets or secured obligation complies with the standard of 'reasonably allowing' identification. In the case of the encumbered asset, it is sufficient for the description to refer to 'all the grantor's movable assets', or all the grantor's assets in a generic category[204] – eg, a flock of sheep.

As regards the secured obligation, the description may include all the debtor's 'obligations owed to the secured creditor at any time'.[205] This generic description still complies with the reasonable identification standard and is particularly relevant for future obligations.[206]

Therefore, the standard for identification under the Model Law and the Guide does not include a strict application of the specificity principle. This differs from the standard applied in some national laws.[207]

(e) Nature of obligations and parties included within their ambit

It is recommended that the law should apply to all security rights created contractually to secure either the payment obligation, or the performance of other obligations.[208] These 'other' types of obligation may include: (1) the transfer of a title in a tangible asset for security purposes; (2)

203 An example is the unique alphanumerical number used for motor vehicles.
204 Article 9(2) of the UNCITRAL Model Law and art 11(2) of the UNCITRAL Model Law: Registry Provisions.
205 Article 9(3) of the UNCITRAL Model Law.
206 Article 9(3) of the UNCITRAL Model Law.
207 See, eg, the strict specificity principle in terms of the South African SMPA discussed in Chapter 2 paragraph 2.5.4.2 *infra*.
208 The preamble to Chapter 1 to the recommendations of the UNCITRAL Guide and Recommendation 2(*d*) of the UNCITRAL Guide.

'assignment of receivables for security purposes'; and (3) the types of retention-of-title agreements and financial leases.[209]

The Guide and Model Law adopt an extensive approach to the types of obligation that may be secured.[210] The obligations can be either: (1) present or future; (2) determined or determinable; (3) conditional or unconditional; or (4) fixed or fluctuating.[211] Accordingly, the specificity principle does not apply, and both fluctuating obligations and obligations phrased in a general way may be included in the security agreement.[212] The extensive scope of the types of obligation which may be included is aimed at facilitating modern financing transactions.[213]

As party autonomy is a key objective, parties must be allowed the maximum flexibility to structure their transaction to fulfil their commercial purpose, while still qualifying as a secured transaction. This objective, therefore, also applies to the obligations that the parties wish to secure. Accordingly, parties may deviate from or vary the provisions of the Model Law.[214] There are, however, specific mandatory provisions[215] in respect of which derogations or variations will only apply *inter partes*.[216]

Historically, the use of certain specific security devices was reserved for certain types of financier. A common example is statutory pledges created in the agricultural sector which carry specific benefits for the state or other parties – eg, co-operatives – as the credit provider.[217] Another example under Belgian law, was the pledge over a business (*pand handelszaak*) which extended over all movable assets of an enterprise save for 50 per cent of its inventory, which was available only to banks and financial institutions.[218] A floating charge is yet another

209 Recommendation 2(*d*) of the UNCITRAL Guide.
210 Chapter I of the UNCITRAL Guide para 12 at 34.
211 Chapter I of the UNCITRAL Guide para 12 at 34 and recommendations 2(*c*) and 16 of the UNCITRAL Guide. See also art 7 of UNCITRAL Model Law.
212 Recommendation 2(*c*) of the UNCITRAL Guide.
213 UNCITRAL Model Law: Guide to Enactment para 91 at 33.
214 Article 3(1) of the UNCITRAL Model Law.
215 Article 4 (General standard of conduct), art 6 (creation of a security right), art 9 (description of the encumbered asset and secured obligations), art 53 (obligation of the party in possession to exercise reasonable care), art 54 (obligation of the secured creditor to return an encumbered asset), art 72(3) (post-default rights, none of the parties may waive unilaterally or vary by agreement, any right to the enforcement of a security right), and arts 85-107 (conflict-of-law provisions).
216 Article 3(2) of the UNCITRAL Model Law.
217 The South African Land Bank and Agricultural Development Bank, a state entity, is distinguished from other credit providers in terms of the Land Bank and Agricultural Development Bank Act 15 of 2002. Also, a cooperative under the Co-Operatives Act 14 of 2005, may acquire a statutory pledge under this Act not available to other credit providers in the agricultural industry.
218 This was provided for in Act 25 of October 1919, but since recent legislative amendments this type of security device no longer only vests in favour of financial institutions. See E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 242.

example; it vests in the assets of a company and, consequently, only a company may grant this type of security.

The Guide strives for equal treatment of all types of creditor. Accordingly, the provisions of the Guide apply equally to all types of financier (sellers or lenders) and debtors. This thesis questions whether equal treatment is fully possible, especially where ownership is used as security. Where only one type of ownership is known, as is the case in civil-law countries, it is simply not possible for a traditional security right and an ownership right to have the same content. After all, ownership is an absolute right while a security right is a limited property right.[219]

3.3.3.2 Functional, integrated, and comprehensive approaches

According to the Guide and Model Law, the approach to secured transactions law should be 'functional, integrated and comprehensive'.[220] In the previous paragraph we discussed the meaning of 'comprehensive'. This paragraph clarifies what is meant by the functional and integrated approaches. Essentially, implementing a 'functional, integrated and comprehensive' approach means that the legal framework can implement either a unitary or a uniform approach.[221]

(a) Functional approach

The functional approach essentially entails that the substance of a transaction is preferred over its form.[222] This approach operates on the assumption that all secured transactions fulfil a similar 'economic function'.[223] This function (also referred to as the operative result) is that the interest in the property secures payment of a loan or the performance of an obligation set out in the security agreement, regardless of whether the security right is classified as a

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219 This argument is revisited in Chapter 5 paragraphs 5.4.1.1(*a*) & (*b*), 5.4.1.2(*a*) *infra*.

220 Introduction of the UNCITRAL Guide para 62 at 23; Chapter I of the UNCITRAL Guide para 104 at 56; and the UNCITRAL Model Law: Guide to Enactment para 22 at 11.

221 Chapter I of the UNCITRAL Guide para 110 at 57, 58.

222 This concept is defined in Chapter 2 paragraph 2.2 of this study at 5. See also, the Purpose to the UNCITRAL Guide para (b). Further, see recommendation 8 of the UNCITRAL Guide and MG Bridge *et al* 'Formalism, functionalism, and understanding the law of secured transactions' (1999) 44 *McGill LJ* 567 at 572.

223 I Davies 'The reform of English personal property security law: functionalism and article 9 of the Uniform Commercial Code' (2004) 24 *Legal Stud* 295 at 300. Also see, NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 88.

'traditional security right' or as something else.[224] The approach makes it possible for all types of security right to be subjected to identical – or at least very similar – rules under a secured transactions law framework.

The functional approach is essentially achieved either by: (1) re-classifying all security devices as a category comprising a single generic unitary security right (the unitary concept) – the UNCITRAL Model Law follows the unitary approach; or (2) keeping the traditional labels for the security devices – pledges, mortgages, and retention-of-title – but applying uniform legal rules to all these devices (as far as possible).[225] In respect to the second type of application of the functional approach, the 'conceptual diversity' of the security devices is disregarded while still using a 'common set of rules governing the creation, third-party effectiveness, priority and enforcement' of all security rights. The outcome of the functional approach is to treat all secured creditors equally by applying a single set of rules which aim at producing functionally equivalent results.[226] Each legal jurisdiction will be able to use its own 'concepts, terminologies, and operative results of individual legal rules' provided that it achieves the same operative or functional result.

The Guide provides the alternative of using either the unitary approach, or a non-unitary approach which closely resembles the second option *supra*.[227] Under the Guide's non-unitary yet functional approach to acquisition financing, the label assigned to traditional title-based security devices – retention-of-title and financial leases – is preserved, but in following a functional approach, these devices must conform to the same rules as other acquisition security rights.[228] However, the rights under a retention-of-title and a financial lease are not classified as security rights. The viability of this application of the functional approach is discussed further under acquisition financing *infra*.[229] Adopting a functional approach is essential to the application of the integrated approach, to which we now turn.

(b) Integrated approach

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224 I Davies 'The reform of English personal property security law: functionalism and article 9 of the Uniform Commercial Code' (2004) 24 *Legal Stud* 295 at 300. See further, mention of the functional approach under the *Purpose to the UNCITRAL Guide* and recommendation 8 of the UNCITRAL Guide.

225 See the uniform system of rules that apply to the OAS Model Law explained in Chapter 4 paragraph 4.3.3.1 *infra*.

226 Purpose to the UNCITRAL Guide para (b).

227 The OAS Model Law follows the second approach. It could be argued that the UNCITRAL Guide found the inspiration for the non-unitary approach to the acquisition security rights in the OAS Model Law.

228 Chapter IX of the UNCITRAL Guide para 76 at 337, paras 80-81 at 338.

229 See paragraph 3.3.4.3 *infra*.

The integrated approach entails a unified approach to all security devices.[230] In simple terms, all security devices are integrated into a single legal framework. However, this does not necessarily mean that a unitary concept, as explained *supra*, applies. The different security devices may still be 'labelled' separately. Therefore, 'integrated' means that the same mandatory rules or principles apply to all security devices that form part of a legal framework unless there is a policy reason for deviating from a standard rule. According to the Guide and the Model Law, all transactions that create a security right in any asset should be regarded as secured transactions. Consequently, the same rules – or at least the same principles – must apply equally to all secured transactions.

The integrated approach involves specific interventions. First, all laws concerning non-possessory security rights must be combined into one concise and clear document.[231] At the same time, outdated rules on possessory pledges should be updated during the reform and be merged, along with the rules relating to non-possessory security rights, into a single concise document.[232] Moreover, a reform which is functional, integrated, and comprehensive creates the opportune point at which to integrate title-based security devices and other contractual arrangements as part of the secured transactions law framework. This avoids having 'secret security rights' forming part of a framework.[233] Finally, the same procedures should apply to all types of creditor which will ultimately improve competition between the role players and place them on equal footing.[234]

3.3.3.3 Allowing security rights in future assets

In terms of article 2(*n*) of the Model Law, a future asset is 'a movable asset, which does not exist or which the grantor does not have rights in or the power to encumber at the time the security agreement is concluded.' According to the Guide, a security right may exist in an asset which 'may not yet exist or that the grantor may not yet own or have the power to encumber',

230 The Australian regime follows a 'unified and functional' approach' as well. See V Barns-Graham & L Gullifer 'The Australian PPS reforms: what will the new system look like?' (2010) July *Law and Financial Markets Review* 394 at 395.
231 Chapter 1 of the UNCITRAL Guide para 105 at 56.
232 Chapter 1 of the UNCITRAL Guide para 105 at 56.
233 Chapter I of the UNCITRAL Guide para 105 at 56. This can be by following either a unitary or a non-unitary approach to acquisition finance.
234 Chapter I of the UNCITRAL Guide para 105 at 56.

thus a 'future asset'.[235] A security right may be created in respect of future assets under both UNCITRAL instruments.[236]

Allowing a security right in future assets is particularly useful: (1) when dealing with revolving assets like inventory; and (2) when using the 'all-assets' security right as a functional equivalent to floating type devices. Commercially, this makes sense as the debtor may need to access credit to purchase the future assets, which, in turn, must be resold to repay the original debt. Further, when the future asset comes into existence, there is no need for the debtor to sign any additional documents other than the security agreement, or prepare an additional filing distinct from the original filing. Even though creating a security right in property that does not yet exist is 'disturbing to the traditional conception of a security right as a *jura in re aliena*', it is impossible to have a modern and practically useful secured transactions framework without amending this fundamental rule.[237]

Essentially, a security agreement may extend to future assets under circumstances where the security right in future assets is not created when the security agreement is signed, but rather as soon as the grantor acquires a right or has the power to encumber the assets.[238] In respect of a future asset, the debtor obtains the right to encumber the asset only after concluding the security agreement. Where notice of this future asset has been filed, it is technically incorrect to say that the secured creditor enjoys a preference from the date of notice filing, as the security right did not exist at that time.[239] The preferential right only becomes enforceable once the security right exists. However, the date which determines priority ranking of a secured claim, depends on the date on which the notice was filed (advance notice filing). In other words, it is entirely possible that the date used to determine priority can pre-date the existence of the security right.

A single notice is enough to provide third-party effectiveness to multiple security rights – present, future, and originating from more than one security agreement.[240] But the description in the notice must still allow for the reasonable identification of the assets described in the

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235 Recommendation 17 of the UNCITRAL Guide.

236 Article 6(2) of the UNCITRAL Model Law and recommendation 13 of the UNCITRAL Guide (creation of a security right).

237 AM Garro 'The creation of a security right and its extension to acquisition financing devices' (2010) 15 *Unif L Rev* 375 at 381.

238 Chapter II of the UNCITRAL Guide para 55 at 78-79.

239 This is probably related to the fact that the security right is a property right which is a right to the encumbered asset, so the person providing the security right, must have a right to the collateral.

240 Recommendation 68 to the UNCITRAL Guide and Chapter III of the UNCITRAL Registry Guide para 125 at 50.

security agreement in question. Where the notice fails to identify the encumbered asset with the required degree of specificity, a new or amendment notice needs to be filed.

3.3.3.4 Allowing security rights over proceeds of encumbered assets

This paragraph addresses what should be included under the definition of 'proceeds', and then turns to whether the original security right extends automatically into all types of proceeds, or whether additional conditions must be met for the security right to extend to the proceeds.

The UNCITRAL instruments' approach to proceeds is inspired by the fact that the creditor's only guarantee of payment is locked in the encumbered asset. Therefore, where the asset is sold, the creditor must either be able to follow the asset into the hands of a third party, or have recourse to the proceeds from that sale. Accordingly, a security right must extend to the proceeds (in the wider sense) originating (generated or produced) from the encumbered asset.[241] Essentially, 'proceeds' encompass that which domestic laws characterise as fruits (natural and civil) and the earnings arising as a result of disposing of or transferring the encumbered asset. Extending the security right to the fruits of the encumbered property is potentially less intrusive on third-party rights, and as a rule, a security right automatically extends to fruits. However, 'proceeds of sale' are regarded as 'replacement property', traditionally no able to be covered by the security right which exists in the *original* encumbered property.[242] As a result, the Guide and Model Law recommend, in line with the more modern approach, a wider scope to what should be regarded as proceeds. According to the UNCITRAL Model Law, proceeds include

> '…whatever is received in respect of an encumbered asset, including what is received as a result of a sale or other transfer, lease, licence or collection of an encumbered asset, civil and natural fruits, insurance proceeds, claims arising from defects in, damage to or loss of an encumbered asset, and *proceeds of proceeds* (emphasis added)'.[243]

241 Chapter I of the UNCITRAL Guide para 62 at 23.
242 Chapter I of the UNCITRAL Guide para 23 at 36, 37.
243 The definition contained in the Glossary to the UNCITRAL Guide, included under 'Introduction' at 11 and 12, is almost exactly the same, but it does not include the part emphasised in this definition. Nevertheless, recommendation 19 of the UNCITRAL Guide, which deals with the continuation of a security right in proceeds, includes a reference that 'identifiable proceeds' include 'proceeds of proceeds'.

The Guide's definition of proceeds differs in the following respects from that of the Model Law quoted above: (1) an additional reference to 'revenues', 'dividends', and 'distributions' is included;[244] and the Guide uses 'disposition' as an alternative to 'sale', where the Model Law uses 'transfer' as the alternative to 'sale'. The implication of using 'transfer' as an alternative to 'sale', is that proceeds will not be 'limited to proceeds received by the original grantor'. [245] Consequently, under the Model Law the term includes proceeds received by a transferee of the encumbered asset (the implication of this is discussed *infra*). [246]

The above definitions of 'proceeds' includes a wider range of situations than under most national laws. Proceeds include both civil and natural fruits, and any proceeds resulting from the disposition of the encumbered asset (in case of the Guide),[247] and proceeds resulting from the transfer of the encumbered asset (in terms of the Model Law). Under the Model Law, 'proceeds' also extend to the proceeds received by a transferee (a person who acquired an asset subject to an existing security right) of the encumbered asset.[248] On the one hand, the approach of the Model Law in including the proceeds *received by the transferee,* provides the secured creditor with an alternative route of recourse. Thus, the Model Law provides an 'additional level of recourse' to proceeds retained not only by the debtor, but also those proceeds received by the person who acquires the asset from the debtor. However, this additional recourse leads to a lack of publicity where the person who acquires the encumbered asset from the subsequent transferee, will not be able to find an encumbrance in respect of the asset where the transferee's name is used to search the register (used to register the security right). The original security right extends to 'proceeds of proceeds' so whether including proceeds resulting from the transfer of the encumbered property raises an issue, depends on whether the security right continues to exist in proceeds in perpetuity.

There is one recommended exception to the general rule that proceeds must be *identifiable.* Both the Guide and the Model Law recommend an exception for *proceeds in the form of money or funds* that become commingled funds.[249] The security right will extend to commingled money or funds even though the funds are no longer identifiable. This notwithstanding, the security right can only extend to the value of the pre-commingled money

244 The Model Law correctly does not include these terms as they fall under the general classification of 'civil fruits' which forms part of the quoted definition above.
245 Chapter 1 of the UNCITRAL Model Law: Guide to Enactment para 60 at 22.
246 Chapter 1 of the UNCITRAL Model Law: Guide to Enactment para 60 at 22.
247 Chapter II of the UNCITRAL Guide para 73 at 84.
248 Chapter 1 of the UNCITRAL Model Law: Guide to Enactment para 60 at 22.
249 Recommendation 20 of the UNCITRAL Guide and art 10(2) of the UNCITRAL Model Law.

or funds.[250] It is entirely possible that the value of commingled money or funds may drop below the value of the pre-commingled money or funds. Where this happens, the security right is limited to the lowest value of the commingled money or funds during the period between commingling and when the security right is claimed.[251]

The security right in the proceeds is equal in value to the right held in the original encumbered property. Also, the priority ranking is determined with reference to the priority of the security right in the original encumbered asset. However, as a security right is a property right, where the original encumbered property no longer exists, an independent security right will exist in respect of the proceeds.

The Guide and Model Law recommend the *automatic* extension of the 'security right in the encumbered asset to its *identifiable* proceeds' (emphasis added).[252] The effect is that where the original security right was effective against third parties, the security right in the proceeds automatically becomes effective against third-parties.[253]

The automatic extension of the security right to the proceeds of the encumbered asset involves some competing policy considerations.[254] The purpose of registration is to alert a third party to the existence of the security right.[255] However, the automatic extension of the security right to the proceeds exists to relieve the 'monitoring burden and priority risk' for the creditor.[256] Where the security right in the proceeds is automatically created as soon as the proceeds arise, there is either a complete lack (where the original notice did not mention proceeds), or reduced level of notification (where the original notice mentioned proceeds, but there is no way to notify that the proceeds now exist). The Model Law and Guide's compromise to resolve this policy conflict is to provide that the automatic extension to the proceeds must be temporary, allowing an opportunity for the creditor to file a separate notice for a security right in the proceeds.[257] The temporary extension makes sense if the assumption is correct that there is an independent security right in the transformed asset.

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250 Article 10(2)(*b*) of the UNCITRAL Model Law and recommendation 20 of the UNCITRAL Guide.
251 Article 10(2)(*c*) of the UNCITRAL Model Law and recommendation 20 of the UNCITRAL Guide.
252 Recommendations 19 of the UNCITRAL Guide and Chapter II of the UNCITRAL Guide para 81 at 86. See also art 10 of the UNCITRAL Model Law.
253 Recommendation 39 of the UNCITRAL Guide and Chapter III of the UNCITRAL Guide para 88 at 125.
254 Chapter III of the UNCITRAL Guide para 90 at 125.
255 Chapter III of the UNCITRAL Guide para 67 at 119.
256 Chapter III of the UNCITRAL Guide para 90 at 125.
257 Chapter III of the UNCITRAL Guide para 92 at 126. UCC Article 9 also allows temporary automatic perfection until notice filing can take place in respect of the proceeds. See UCC § 9-315(*d*).

There are exceptions where the security right would not extend to proceeds. These exceptions are either contractual which only apply *inter partes*, or universal which apply to all secured transactions. An example of a contractually-agreed exception is an agreement that the security right does not extend to the proceeds of the encumbered asset.[258] This exception illustrates the importance of the principle of party autonomy. A universally recognised exception in respect of proceeds relates to a security right not extending to a specific type of proceeds (as with non-cash proceeds from acquisition finance, referred to as receivables).[259]

3.3.3.5 Clear distinction between security rights being effective: *inter partes* (creation) or against third parties (third-party effectiveness)

The UNCITRAL Guide and Model Law distinguish between the creation and third-party effectiveness of a security right. Creation of a security right is linked to a specific action, the conclusion of the security agreement. Equally, third-party effectiveness[260] must occur as a result of *another* separate action, a form of publicity.

The novel suggestion of separating the creation and the all-encompassing third-party effectiveness arose, in the main, for two reasons. The first and less convincing reason is that it should be possible to take multiple security rights in one asset. Lukas points out that other legal frameworks – which do not distinguish between the creation and third-party effectiveness as do the Guide and Model Law – permit a subsequent creditor to acquire a *secondary* right in the same asset, subject to having a lower priority ranking.[261] As regards the UNCITRAL instruments, each security right in a single asset applies *inter partes* only until the third-party effect is in place. But, a security right is regarded as a property right; and although the security right only applies between the parties, in practice, its enforcement would result in the possession and disposition of the secured asset (as the security right exists in the asset). Where there are multiple creditors holding security rights, which creditor (in the same asset) will have the right to enforce the security right in the asset. It is difficult to argue this third-party effect

258 Chapter II of the UNCITRAL Guide para 81 at 86 and recommendations 80(*a*) of the UNCITRAL Guide. See further art 34(2) of the UNCITRAL Model Law.

259 This would probably also relate to a policy choice to protect the financier that take receivables as security. This provision is similar to UCC Article 9 where a security interest only automatically extends to cash proceeds.

260 Chapter III of the UNCITRAL Guide deals with the 'Effectiveness of a security right against third parties'. 'Perfection' is a similar term, but has a different meaning within the context of the UCC Article 9 and jurisdictions which have adopted protection of personal security Acts in line with art 9. These regimes are referred to as PPSA regimes or jurisdictions, but hold a different meaning and legal consequence.

261 M Lukas 'Attachment/creation of security interest' (2008) 5 *ECFR* 135 at 139.

away where we are dealing with a 'right in a property'. Everything is resolved when third-party effectiveness of the security right takes effect, but until then the position remains uncertain.

The second reason for distinguishing between creation and third-party effectiveness is that a secured creditor should not have to wait to take steps to guarantee the priority of her security right. Consequently, as it is easier to create a contractual obligation, the security agreement must create a contractual property right, which would allow the creditor recourse to the debtor's asset – as opposed to having only a personal obligation against the debtor to repay a debt.[262]

The clear separation of creation and third-party effectiveness deviates from the usual domestic-law approach. In the first instance, it goes against the 'all-or-nothing approach' where a proper security right is created only after publicity (with no *inter partes* application before publicity).[263] However, this clear distinction also deviates from the position where a jurisdiction acknowledges a reservation of ownership, and both creation and third-party effectiveness takes place when the security agreement is concluded (third-party effectiveness does not depend on publicity as the principles of transfer of ownership apply).[264] Accordingly, including proper security rights and *quasi*-security rights in a single framework will present challenges where this clear separation between creation and third-effectiveness needs to be implemented. The specific provisions on the creation and third-party effectiveness under the Guide is considered further *infra.*

(a) Creation of a security right through a security agreement

In the Guide and Model Law, creation means that the security right becomes effective between the secured creditor and debtor (or grantor) by concluding the security agreement. The UNCITRAL Model Law defines a security right as:

> '(i) A *property right* in a movable asset that is *created by agreement* and secures payment or other performance of an obligation, regardless of whether the parties have denominated it as a security right; and

262 Chapter II of the UNCITRAL Guide para 3 at 65.
263 M Lukas 'Attachment/creation of security interest' (2008) 5 *ECFR* 135 at 140.
264 M Lukas 'Attachment/creation of security interest' (2008) 5 *ECFR* 135 at 140.

(ii) The right of the transferee under an outright transfer of a receivable by agreement;' (emphasis added).'[265]

The Guide follows (i) of this definition, but (ii) is replaced by:

> '(ii) In the context of the unitary approach to acquisition financing, the term includes both acquisition security rights and non-acquisition security rights. In the context of the non-unitary approach to acquisition financing, it does not include a retention-of-title or financial lease right. Although an outright transfer of a receivable does not secure payment or other performance of an obligation, for the convenience of reference the term also includes the right of the assignee in an outright transfer of a receivable. The term *does not include a personal right* against a guarantor or other person liable for the payment of the secured obligation' (emphasis added).[266]

Accordingly, a security right is regarded a contractually-created *property right.*[267] Traditionally, a property right is distinguished from a personal right in that the former has a certain proprietary effect which has two consequences in the secured transactions law context. First, a security right is created in an asset of the person providing the security; and second, the security right applies *erga omnes* (against the world).[268] The security right under both the Guide and Model Law applies *inter partes,* but does not include a personal right. Thus, the security right under the UNCITRAL instruments only *appears* to be a contractual right in that it only applies *inter partes;* it nonetheless remains a right in the property.[269] Clearly, this definition of a security right as a property right under the UNCITRAL framework presents some challenges. The crisp question is whether it is practically possible and commercially relevant to have a contractually-created property right (which is not a personal right) that can only apply *inter partes*.[270]

Legal jurisdictions attach different legal consequences to the creation of a security right.[271] Röver identifies classifications of different legal consequences attached to the creation

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265 Section 2(*kk*) of the UNCITRAL Model Law. Paragraph (ii) was included as an outright transfer of receivables is not usually regarded as a security device.

266 Introduction to the UNCITRAL Guide at 13.

267 The UNCITRAL Guide on the Implementation of a Security Rights Registry (UNCITRAL Registry Guide) added 'limited' and defines a security right as a limited property right. See Introduction para 12 at 8.

268 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 112.

269 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 128.

270 M Lukas 'Attachment/creation of security interest' (2008) 5 *ECFR* 135 at 137.

271 See Chapter II of the UNCITRAL Guide paras 1-4 at 65, 66.

of a security right.[272] One approach is that the creation of the security right and third-party effectiveness take place simultaneously,[273] described as the 'all-or-nothing approach'.[274] Another approach arises from the two-step process followed under UCC Article 9 and legal jurisdictions which follow the Article 9 approach.[275] Under this approach, attachment to the collateral creates an effect both between the parties and between the creditor and other *unsecured* creditors of the debtor, while perfection (as separate action) renders the security interest enforceable against all third-parties. 'Creation' under the Guide and Model Law (and legal jurisdictions which follow the UNCITRAL approach) adds another classification in terms of which the security right – as a property right – is created contractually; in other words with the conclusion of the security agreement. But, under the UNCITRAL instruments the security right only applies between the contracting parties although it allows the creditor access to the debtor's encumbered asset.

As the Guide and Model Law apply to *contractually* created security rights, the law of contract in each legal jurisdiction will determine whether a valid contract exists or has entered into force. In line with party autonomy, the parties are free to include any lawful provision in the security agreement, subject to specific uniform mandatory rules concerning the information that must be included, as well as the general format of the agreement. According to the Guide and Model Law, the security right is created when the parties conclude the security agreement, subject to the grantor having the power to encumber the asset at the point.[276] This allows for a different date when a security right in a future asset is created.[277] Therefore, the existence of the security right depends on the existence of a valid and enforceable security agreement.[278]

The Guide's Glossary and article 2 of the Model Law (the definitions section) define a security agreement similarly. The grantor and secured creditor need not call their agreement a 'security agreement' – it will be a security agreement either when: (1) the agreement provides that a security right as defined by the UNCITRAL instruments is created; or (2) the agreement provides for an outright transfer of a receivable. [279]

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272 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 112.

273 The South African framework follows this approach. See Chapter 2 paragraph 2.3.2 *supra*.

274 M Lukas 'Attachment/creation of security interest' (2008) 5 *ECFR* 135 at 140.

275 For example, s 36 of the New Zealand PPSA and s 19(2) of the Australian PPSA.

276 Recommendation 13 of the UNCITRAL Guide and art 6 of the UNCITRAL Model Law.

277 See the discussion in paragraph 3.3.3.3 *infra*.

278 It becomes enforceable when there is compliance with the suspensive conditions.

279 Glossary to the UNCITRAL Guide, included under 'Introduction' at 13, and art 2(*jj*) of the UNCITRAL Model Law.

The general rule is that the security agreement must be in writing unless an oral agreement accompanies the secured creditor taking possession of the encumbered asset.[280] However, the meaning of 'writing' is broad enough to include any record or electronic communication that is accessible at a later stage as proof that the agreement was concluded.[281] Recommendation 14 of the Guide and article 6 of the Model Law set out the requirements with which an agreement must comply to qualify as a security agreement. In terms of recommendation 14 of the Guide, a security agreement must contain the following elements to be effective between the debtor and creditor: (1) it must reflect a shared intention between the parties to create a security right (this requirement is not included in the Model Law); (2) the secured creditor and grantor must be properly identified (this requirement forms part of the Model Law);[282] (3) the agreement must describe the secured obligation (the Model Law contains an additional requirement in respect of the standard of the description); (4) the encumbered asset must be described to reasonably allow identification of the asset;[283] (5) and the agreement must specify 'the maximum monetary amount for which the security right' can be enforced. Article 6 of the Model Law contains similar requirements save for the following provisions unique to the Model Law: (1) *both* the secured obligation and the asset must be identified in a 'manner that reasonably allows their identification' (so the standard also applies to the secured obligation);[284] (2) the security agreement need not reflect a shared intention between the parties to create a security right; and (3) unlike the Guide, the security agreement must be signed by the grantor (if it is in writing).[285] The Guide is not very prescriptive as to whether the signature of any of the parties is required, unlike the OAS Model Law which requires the signature of the debtor (which corresponds to the Model Law).[286] The Guide only requires a reliable method by which to identify the parties and reflect their intention to be bound by the terms of the security agreement.[287]

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280 Recommendation 15 of the UNCITRAL Guide and art 6(4) of the UNCITRAL Model Law.

281 Recommendation 11 of the UNCITRAL Guide.

282 See the discussion *infra* on the distinction between the description of legal persons and natural persons in the registry. The descriptions in the registry and security agreement must correspond.

283 This means that the description is sufficiently clear and complies with the public policy limitation imposed by countries to protect consumers. This relates to the principle of 'specificity' that results in transparency.

284 Article 6(3)(*b*) of the UNCITRAL Model Law.

285 Article 6(3) of the UNCITRAL Model Law.

286 The debtor's consent is expressed by a signature and serves as a means of protecting the debtor. Earlier drafts of the Guide contained a similar provision to that in the OAS Model Law, but this was omitted in the final document. See A Veneziano 'Attachment/creation of a security interest' (2008) 5 *ECFR* 113 at 115.

287 Recommendation 12 of the UNCITRAL Guide.

Under the UNCITRAL instruments' approach, third-party effectiveness requires an additional act of publicity (registration, or possession, or control of the encumbered asset), which is the topic of the next paragraph.

(b) Effectiveness against third parties

Legal frameworks potentially use different terminology for what are essentially functionally-equivalent concepts (concepts serving similar legal functions) for the security right to be generally enforceable *erga omnes*.[288] There are certain instances where the *erga omnes* enforceability of the security right will not apply – eg, transfer in the ordinary-course-of-business exception discussed *infra*. The third-party effectiveness further involves the right to follow the encumbered asset into the hands of the transferee.

The UNCITRAL instruments refer to 'third-party effectiveness' and even both: (1) the UCC Article 9 and PPSA legal jurisdictions; and (2) other national legal systems which do not follow UCC Article 9, refer to 'perfection', although the precise meaning of perfection may differ between these groups.[289] Essentially, under the UCC Article 9 and PPSA regimes, perfection is 'a tool of the priority regime'. The reason for this is that the security interest is already effective against *unsecured* creditors when attachment takes place.[290] Consequently, perfection improves the priority ranking a secured creditor has against competing *secured* creditors.[291] Nevertheless, both these terms (third-party-effectiveness and perfection) imply that the secured creditor has taken additional steps after creation (which is the case under the UNCITRAL instruments) or attachment (applied in the UCC Article 9), respectively.[292] The result of the additional steps is that the security interest (right) becomes binding against *all* other creditors, both secured and unsecured – as opposed to binding only *inter partes* or only against unsecured creditors. The general enforceability of the security right arises after additional steps have been taken: (1) registration or filing; (2) transfer of possession of

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288 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 162.

289 In a jurisdiction not following UCC Article 9, perfection implies that as soon as the security right is created, it also becomes enforceable against third parties (which is the position under the South African framework).

290 See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) and the source listed at n 46 at 171.

291 Competing third parties may include: other secured creditors, the trustee of the debtor's insolvent estate, or in limited instances, subsequent buyers of the collateral. See this list in A Veneziano 'Attachment/creation of a security interest' (2008) 5 *ECFR* 113 at 119.

292 However, as an exception, certain security rights automatically become enforceable against third parties. For example, the security rights that extend to proceeds, a mass, or a product.

corporeal movable property; and (3) transfer of control in respect of certain incorporeal movable property. However, some security rights – eg, retention-of-tile – achieve third-party effect without an additional act.

According to the Guide and the Model Law, a security right is created when the security agreement is effective *inter partes*, but the third-party effectiveness is deferred until the publicity of the existence of the security right takes place.[293] One way of achieving third-party effectiveness is through notice filing. The idea is that the notice provides sufficient information to reflect that the secured party (who filed a notice) could have a security right in the described collateral. Effectively, notice filing provides a 'warning flag' of the possibility of an encumbrance in a specific asset.[294] Nevertheless, the fact that notice filing of the security right has taken place, is not conclusive proof that a security right exists.[295] Accordingly, the purpose of registration is merely to alert the public that a security right may exist.[296] It is conceivable under the UNCITRAL instruments, to file a *notice* in a registry before a security agreement is concluded. Advance filing is, therefore permitted under the UNCITRAL approach. Nevertheless, the security right referred to in the notice only becomes effective against all third parties once the security agreement enters into force and so creates the security right.[297] As the filed notice relates to the *possibility* of that the security right exists, notice filing does not here contravene the accessoriness principle.[298]

Third-party effectiveness in the context of the Guide and the Model Law takes place in any of the following ways: registration in a general registry;[299] registration in a specialised registry or notation on a title certificate (only applicable to the Guide);[300] transfer of possession;[301] or transfer of control which applies to specific types of asset (only mentioned in the Guide).[302] Even though registration is the preferred method,[303] the other methods are

293 This differs from UCC Article 9 where the security interest is effective against a select group of third parties (unsecured creditors) upon attachment, but perfection influences the priority of secured creditors.
294 HC Sigman 'Some thoughts about registration with respect to security rights in movables' (2010) 15 *Unif L Rev* 507 at 508, 509.
295 Recommendation 33 of the UNCITRAL Guide and Chapter III of the UNCITRAL Guide para 35 at 111.
296 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 131.
297 Chapter III of the UNCITRAL Guide para 37 at 112.
298 See Chapter 2 paragraph 2.3.3.3(a) *supra* for the meaning of this principle.
299 Recommendation 32 of the UNCITRAL Guide and art 18(1) of the UNCITRAL Model Law.
300 Recommendation 38 of the UNCITRAL Guide.
301 Recommendation 37 of the UNCITRAL Guide and art 18(2) of the UNCITRAL Model Law.
302 For example, to obtain control of the 'right to receive proceeds under an independent undertaking' (recommendation 50 of the UNCITRAL Guide) or the 'right to payment of funds credited to a bank account' (recommendation 49 of the UNCITRAL Guide).
303 Recommendation 32 of the UNCITRAL Guide.

retained as alternatives suited to specific types of asset.[304] However, the third-party effectiveness of letters of credit is excluded from the Model Law.[305]

Also, where a security right in a tangible asset achieves third-party effectiveness, this right automatically continues into the mass or product without the need for further action (thus automatic third-party effectiveness).[306] It is also suggested that automatic third-party effectiveness only persists in specific types of proceeds (without having to mention this in the original registered notice). The specific types of proceeds include 'money, receivables, negotiable instruments or the rights to payment of funds credited to a bank account'.[307] Where a type of proceeds is not included in the list above, it is recommended that the security right is maintained in these proceeds for limited period, after which the security right in the proceeds must be registered to remain effective against third parties.[308] Further, the Guide recommends that a security right which existed in a movable asset but which has subsequently become attached to immovable property, can possibly be registered in the immovable property register or, alternatively, can also be regarded as automatically effective against third parties.[309]

Both the Guide and the Model Law recommend that possession be retained as a method for achieving third-party effectiveness. The Guide defines possession as:

> '…the *actual* possession of a tangible asset by a person or an agent or employee of that person, or by an independent person that acknowledges holding it for that person. It does not include *non-actual* possession described by terms such as *constructive, fictive, deemed or symbolic* possession' (emphasis added).[310]

The Model Law's definition is simpler. First, the Guide's reference to 'an agent or employee of that person' is replaced with 'its representative' under the Model Law.[311] Also,

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304 For example, in relation to possession: negotiable instruments in order to retain the negotiability of the instrument (Chapter III of the UNCITRAL Guide para 49 at 115); uncertificated non-intermediated securities through the conclusion of a control agreement (art 27 of the UNCITRAL Model Law); the right to payment of funds credited to a bank account, through the conclusion of a control agreement or the secured creditor becoming an account holder (art 27 of the UNCITRAL Model Law); and possession of a negotiable document where the asset is covered by this document (art 26 of the UNCITRAL Model Law).

305 SV Bazinas 'The OAS and the UNCITRAL Model Laws on Secured Transactions compared' (2017) 22 *Unif L Rev* 914 at 921.

306 Recommendation 44 of the UNCITRAL Guide and art 20 of the UNCITRAL Model Law.

307 Recommendation 39 of the UNCITRAL Guide and art 19(1) of the UNCITRAL Model Law.

308 Recommendation 40 of the UNCITRAL Guide and art 19(2) of the UNCITRAL Model Law.

309 Recommendation 43 of the UNCITRAL Guide.

310 Glossary to the UNCITRAL Guide included under 'Introduction' at 11.

311 Article 2(*z*) of the UNCITRAL Model Law.

there is no need for the second sentence of the above definition ('it is implied'), which is why this sentence was excluded from the Model Law's definition of possession. This definition of possession only applies to tangible (corporeal) movable assets and does apply to negotiable instruments and negotiable documents in electronic form.[312]

'Constructive possession' does not provide adequate publicity, according to the Guide, as there is no practical need to relax the rules of possession where registration is the preferred form of publicity for non-possessory pledges.[313] The creditor's possession should be 'public, continuous and unequivocal'.[314] It is possible – indeed preferable – for an agent or representative of the secured creditor to take possession of the encumbered asset to satisfy the publicity standard.[315] However, attornment is a form of constructive possession used in warehousing transactions,[316] but this possibility is effectively excluded under the Guide. Possession by a third party on behalf of the creditor (an agent, employee, or independent party) is allowed, but still involves actual possession and then subsequent transfer of possession. Also, where a negotiable document of title includes the rights to the warehoused assets, the warehouse-keeper could deliver that document as a further way of ensuring third-party effectiveness.[317]

The UNCITRAL instruments allows for an exception to the general rule for the third-party effectiveness of a security right – the ordinary-course-of-business exception. The ordinary-course-of-business approach corresponds to a buyer's commercial expectation of acquiring inventory which is sold as part of the seller's normal course of business free from existing security rights.[318] Without this expectation, few would be willing to buy the inventory from the seller and it would not be possible to incorporate an all-asset type of security as part of a framework.[319] However, the position of the secured creditor must also be protected. The ordinary-course-of-business approach can only be applied where: (1) the seller is in the business of selling that type of asset; (2) and where the security agreement prohibits the sale, the buyer must have had no knowledge of the actual provision in the security agreement which

312 Chapter 1 of the UNCITRAL Model Law: Guide to Enactment para 56 at 21.
313 Chapter III of the UNCITRAL Guide para 53 at 116 and Chapter IV of the UNCITRAL Guide para 5, at 150.
314 Chapter III of the UNCITRAL Guide para 52 at 116.
315 Chapter III of the UNCITRAL Guide para 54 at 116. The Guide therefore supports the practice of 'warehousing'.
316 See the discussion of attornment in Chapter 2 paragraph 2.4.3.1(*b*) *supra*.
317 Chapter III of the UNCITRAL Guide para 57 at 117.
318 Chapter V of the UNCITRAL Guide para 69 at 202.
319 The all-asset security is taken in respect of all the debtor's assets. Thus, this type of security only works where it is possible to release revolving assets – eg, inventory – from the encumbrance.

prohibited the sale (mere knowledge that the asset was subject to a security right is not sufficient).[320] These exceptions to the extension of the security right to proceeds, apply equally to the Guide and the Model Law.[321]

The Guide and Model Law contain a separate fundamental principle in terms of which a general security rights registry should be put in place as a means of establishing third-party effectiveness. The next paragraph considers the recommendation that a general security rights registry be established.

3.3.3.6 Establishing a general security rights registry

A general registry notifies the public at large of a change in the status of proprietary interests in the assets of either the debtor or a third party who provides security on behalf of the debtor. The fundamental principle governing the establishment of a general registry relates to how a country's policy choices inform the design of the public register.[322] The purpose which the registry aims to achieve should determine its format.[323] Consequently, the intended purpose informs the choice that must be made between different considerations. Some of these considerations entail: (1) the categories of asset included as part of the registry; (2) deciding between either a notice-filing or transaction-filing framework; (3) having either an asset-based or a debtor-based, notice-filing system;[324] (4) the level of specificity required of the information that forms part of the registered document; and (5) whether using either an electronic-filing system or paper-based filing system, or both, is the preferred approach.

The provisions on establishing a general registry form part of the UNCITRAL Guide, the UNCITRAL Guide on the Implementation of a Security Rights Registry (the UNCITRAL Registry Guide),[325] and the UNCITRAL Model Law (as a separate part within the Model Law).[326] There are two overarching principles for an efficient registry that form the foundation

320 Chapter V of the UNCITRAL Guide para 68 at 202.
321 Recommendations 81(*a*) of the UNCITRAL Guide and art 34(4) of the UNCITRAL Model Law.
322 Introduction to the UNCITRAL Guide para 66 at 24.
323 Chapter IV of the UNCITRAL Guide para 2 at 149.
324 The Cape Town Convention uses an asset-based filing system, which means that the registry is organised and searchable with reference to the identification of the asset. The UNCITRAL Guide recommends a debtor-based filing system which is organised and searchable with reference to the debtor's identity.
325 UNCITRAL Guide on the Implementation of a Security Registry (2013) available at http://www.uncitral.org/pdf/english/texts/security/Security-Rights-Registry-Guide-e.pdf (date of access: 11 November 2014).
326 Article 28 of the UNCITRAL Model Law, referred to as the Model Registry Provisions, with new article numbers 1 to 33. The reference to an article for the purpose of this paragraph is to the renumbered articles that form part of the UNCITRAL Model Registry Provisions.

of the UNCITRAL Registry Guide. The first principle requires that the legal and operational guidelines on how the registry works must be 'simple, clear and certain' from the perspective of the user (the user-friendliness of the registry). Second, the design of the registry must strike a balance between having a 'fast and inexpensive system' and a system which guarantees the 'security and searchability' of the information.[327] The recommendations under the UNCITRAL instruments mentioned above, favour an electronic system[328] which provides public and remote access to users with minimal assistance or intervention from registry staff.[329]

Where a legal system recognises non-possessory security rights, registration remains the most effective way of creating third-party effectiveness transparently.[330] As a result of the transparency principle, the registration method will accordingly have to comply with both the publicity principle, and consider how to apply the specificity principle. The Guide and Model Law suggest a single, general register for all security rights. However, the Guide permits a compromise which allows for the inclusion of the security rights either contained in a specialised registry[331] or noted on a title certificate.[332] These options are included as a concession and have a higher priority ranking than a security right registered in a general registry.[333] Consequently, in terms of the Guide, a security right filed in a general security rights registry is subordinate to these other two rights.[334] The Model Law makes no reference specialised-registry rights or rights noted on a title certificate. Arguably, the higher priority of these security rights under the Guide relates to the fact that as standards that form part of transaction-filing, those registries comply with a higher standard than mere notice-filing.[335] However, this compromise to maintain other registries in addition to the general registry, has the effect of preferring certain types of asset above others.[336] The preferred approach

327 Chapter I of the UNCITRAL Registry Guide para 10 at 7.
328 A paper-based filing system is not the preferred option in terms of the UNCITRAL framework.
329 Chapter II of the UNCITRAL Registry Guide para 91 at 35.
330 See Chapter 2 paragraph 2.3.3.1 *supra* where transparency as a fundamental principle is discussed.
331 An example of a specialised registry would be an asset-specific intellectual property registry. Most legal jurisdictions already have such a registry capable of tailoring for use to publicise a security interest in intellectual property. Other examples include the ship-and aircraft registries.
332 This corresponds to the theme of the provision in § 9-311 of the UCC which applies to certificate-of-title with respect to motor vehicles, aircraft, and waterborne vessels, where notation is treated as an *equivalent* (thus not awarding a higher legal status) to filing a financing statement.
333 Chapter III of the UNCITRAL Guide discusses third-party effectiveness.
334 Chapter III of the UNCITRAL Guide para 86 at 124.
335 Transaction-filing coincides with the filing of a complete document. A complete copy of the security agreement must be filed. Also, the registry staff would have to vet the security agreement. South Africa uses transaction-filing for the registration of notarial bonds under the SMPA.
336 Including this allowance is probably a compromise agreed to between country representatives who approved the Guide.

recommended in this thesis, is that countries modernise their existing specialised registries so that as far as possible only one general registry is maintained.

Recommendation 57 of the UNCITRAL Guide, recommendation 23 of the UNCITRAL Registry Guide, and article 8 of the Model Law Registry Provisions, require specific information as part of the filed notice: (1) the grantor information (name or other identifier and address);[337] (2) information of the secured creditor or its representative (name or other identifier and address);[338] (3) a description of the encumbered asset according to the same standard applied in the security agreement;[339] (4) duration of the registration (meaning the period of effectiveness of registration);[340] and (5) the maximum monetary amount for which the secured creditor will be able to enforce the security right.[341] The same information must be included in the security agreement and the filed notice. Where the asset description in the security agreement differs from that in the notice, security-agreement description prevails.[342] An incorrect statement by the registrant does not render the registration ineffective *per se*. The notice is only ineffective where it would mislead a 'reasonable searcher'.[343] Also, the grantor must authorise the registration of the notice in writing.[344] However, a subsequent written

337 Article 9 of the UNCITRAL Model Law: Registry Provisions, recommendations 59 and 60 of the UNCITRAL Guide, and recommendations 24 and 25 of the UNCITRAL Registry Guide, set out separate rules for identifying the grantor.

338 Article 10 of the UNCITRAL Model Law: Registry Provisions, recommendation 57(*a*) of the UNCITRAL Guide, and recommendation 27 of the UNCITRAL Registry Guide, set out the rules for identifying the grantor.

339 The criteria link to how the asset is described in the security agreement. The asset described in the notice must also be described reasonably to allow for its identification. See art 11 of the UNCITRAL Model Law: Registry Provisions, recommendation 63 of the UNCITRAL Guide, and recommendation 28 of the UNCITRAL Registry Guide. Under the Model Law, there is the option for a state to adopt specific rules to identify high-value assets (serial number or equivalent unique alphanumerical identifier), subject to amendment of the rules on the effect of an incorrect serial number on the priority of the security right. See UNCITRAL Model Law: Guide to Enactment para 187 at 60-61.

340 It is up to the parties to decide for how long the notice will be valid. Registration also lapses automatically after the period for which it was registered comes to an end if there is no allowance for extension of the registration period. See recommendation 69 of the UNCITRAL Guide, art 14 of the UNCITRAL Model Law: Registry Provisions (providing different drafting options as alternatives), and recommendation 11 of the UNCITRAL Registry Guide.

341 Recommendation 57 of the UNCITRAL Guide includes the details on what must be included. *Contra* in terms of UCC Article 9, the maximum amount of the secured obligation need not be publicised. See HC Sigman 'Perfection and priority of security rights' (2008) 5 *ECFR* 143 at 154. However, the discussion in the Guide states that it is possible to register the securing amount as 'unlimited'. This would deal with aspects of confidentiality and security in future assets. However, third-party effectiveness is linked to the principal amount, effectively linking the debtor to an unlimited exposure.

342 See recommendation 14 of the UNCITRAL Guide and Chapter III of the UNCITRAL Guide para 36 at 112.

343 Chapter IV of the UNCITRAL Guide para 84 at 171 and recommendation 65 of the UNCITRAL Guide.

344 Article 2(1) of the UNCITRAL Model Law, recommendation 71 of the UNCITRAL Guide, and recommendation 7(*b*) of the UNCITRAL Registry.

security agreement constitutes retrospective ratification of the unauthorised registration[345] – probably as a result of the grantor also having to sign the security agreement.

The person responsible for the management of the registry will have to determine how to deal with errors in the registered information. Developing an effective electronic platform from where the registry may operate, is the area in which technology can assist with the accuracy required by law.[346] Using a numeric identifier for an individual is preferred. For example, an identification number for an individual or a registration number for a company. This system can then link to other government systems to verify the accuracy of the entry.[347] There should be a distinction between natural and legal persons to enable the system to recognise whether the details entered are those of an individual or juristic person.[348] A change in details must then allow for a grace period for an amendment to be made before the security will lose third-party effectiveness.[349]

Advance registration of a security right that will only exist in the future is possible under both the UNCITRAL Guide and Model Law.[350] Accordingly, the creditor may register a notice before the security right to which the notice relates is created, so allowing advance notice filing.

The filed notice becomes effective from the moment third-party searchers can locate the notice when searching the registry.[351] 'Knowledge', in terms of the Guide and arguably also under the Model Law, refers to actual rather than constructive knowledge.[352] The doctrine of constructive knowledge, therefore, has no application under the UNCITRAL instruments. There is, nonetheless, an obligation on the registry to provide a copy of the notice to the person

345 UNCITRAL Model Law: Guide to Enactment para 152 at 51.

346 Chapter IV of the UNCITRAL Guide para 67 at 165, suggests the use of a 'sophisticated algorithm' for this purpose.

347 Recommendation 59 of the UNCITRAL Guide sets out standards to be used by states.

348 See Chapter IV of the UNCITRAL Guide paras 68-71 at 166-167 and recommendation 59 for a discussion of natural persons, and Chapter IV of the UNCITRAL Guide para 72 at 167 and recommendation 60 for a discussion of legal persons. Under South African law trusts must allow for entry of the name of authoritive person behind the trust.

349 This grace period to correct errors in registration is a far more reasonable process than under the South African SMPA where errors in the asset description, for example, influence the legal status of the real security.

350 Article 4 of the UNCITRAL Model Law, recommendation 67 of the UNCITRAL Guide, and recommendation 13 of the UNCITRAL Registry.

351 Recommendation 70 of the UNCITRAL Guide, Chapter IV of the UNCITRAL Guide para 105 at 175, and the UNCITRAL art 13(1) of the Model Law: Registry Provisions. This is also possible after the Belgian law reform. See E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 245.

352 Introduction of the UNCITRAL Guide: Terminology at 10.

identified in the notice as the secured creditor, and this secured creditor must send a copy of the notice to the grantor (as identified in the notice).[353]

Having a general registry where notices are filed in respect of security rights, also makes it possible for multiple security rights to exist in the same asset. This is another fundamental principle, discussed in greater detail in the next paragraph.

3.3.3.7 It must be possible to take multiple security rights in the same asset

In terms of the Guide and Model Law, a debtor must be able to grant multiple security rights in a single asset to more than one creditor.[354] The clear separation between creation and third-party effectiveness arguably supports the principle that it is possible to acquire multiple security rights in a single asset.[355] Multiple security rights present only minor issues where the rules on third-party effectiveness are clear and if the rights of the respective creditors are subject to clear priority rules. Essentially, using a notice-filing system must make it possible to register multiple security rights in a single asset.[356]

However, more serious concerns arise where different creditors each holds a security right in the same asset and publicity has not yet taken place. The intended security right under the UNCITRAL instruments is a contractually-created property right. Consequently, the secured creditor will have recourse to the debtor's encumbered asset, but the creditor will not be able to enforce the security right against third parties (including other secured creditors with a security right in the same asset). Potentially, as the publicity requirement has not yet been met, a subsequent creditor may be unaware that another creditor already holds a security right in the same asset. There is, therefore, a risk that the secured creditor who subsequently acquires a security right may be unsecured where the asset value is insufficient (no value remains after the first secured creditor's claim has been satisfied). Arguably, the priority of a security right without any third-party effectiveness is determined by considering the date when the security agreement entered into force.

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353 Article 15 of the UNCITRAL Model Law: Registry Provisions, recommendation 55(*c*), (*d*) and (*e*) of the UNCITRAL Guide, and recommendation 18 of the UNCITRAL Registry Guide.

354 Introduction of the UNCITRAL Guide para 67 at 24-25.

355 However, see the criticism raised in paragraph 3.3.2(c) *supra* against needing this elaborate separation merely to allow multiple security rights to exist in a single asset.

356 Recommendation 68 of the UNCITRAL Guide, recommendation 14 of the UNCITRAL Registry, and art 3 of the UNCITRAL Model Law: Registry Provisions (a single filed notice may relate to multiple security rights). This links to the fundamental policy objective that the debtor must be able to use the full inherent value of all its assets as security.

It remains a challenge that multiple security rights can be created in the same property without adequate notice. However, these issues can be avoided if the potential creditor conducts proper due diligence before entering into the secured transaction.[357] As part of the due diligence process, the potential creditor should conduct a proper valuation of the asset to confirm that it represents sufficient value to secure the debts of all the secured creditors involved.[358] Therefore, a framework which allows multiple security rights to exist in one asset without publicity can operate efficiently only if it is set up to enable (and indeed encourage) prospective creditors to conduct proper due diligence before accepting the asset as security.

The possibility of taking multiple security rights in an asset can also be advanced as a probable reason why title-based security devices which use ownership as security, should be re-characterised as a security right. Essentially, if a reservation of ownership is used to secure the performance of an obligation, there cannot be multiple secured creditors, probably even in a legal system which allows for a bifurcate type of ownership.

As has been pointed out, being able to grant multiple security rights in an asset depends on having clear and detailed priority rules. Priority is, therefore, the topic of the next paragraph.

3.3.3.8 Priority determined on a temporal basis using clear and detailed rules

There should be a link between the method used to establish third-party effectiveness and the priority a creditor obtains as a result.[359] Third-party effectiveness determines the 'place' a creditor will have in the 'debt queue'. The priority ranking between secured creditors is determined by considering when the notice was registered, or the date of possession or control, and not the date that the security right was created. Accordingly, priority relates to the 'ranking' of the claim of a secured creditor and distinguishing secured and unsecured creditors.[360] Priority in the context of the UNCITRAL Model Law 'means the right of a person in an encumbered asset in preference to the right of a competing claimant'.[361] Preference over the right of a competing claimant is determined with reference to: (1) the general rule for determining priority (temporal basis); (2) permitted exceptions to the general rule; and (3)

357 A duty to conduct due diligence is not included under the Guide.
358 The valuation should not be a legislative requirement, but rather be included as part of the policy documents of financiers.
359 Chapter III of the UNCITRAL Guide paras 15-18 at 106-107. Also see, NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 164.
360 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 200.
361 Article 2(*aa*) of the UNCITRAL Model Law.

priority between competing security rights in respect of specific types of asset (future assets, proceeds, and a subsequent mass or product). Thus, even though the exceptions allow for deviation from the general priority rule, at least there is certainty about which exceptions to the general rule could apply.

(a) General rule

The purpose of the provisions on the priority of a security right is to determine priority in a 'predictable, fair and efficient way' while also acknowledging that it is possible to create multiple security rights in the same asset.[362] The general rule under the UNCITRAL instruments is to use a temporal basis for determining priority among the competing security rights.[363] This means that the basis for determining priority is 'time-based'. A temporal priority approach depends on the date on which the claim *became effective* against third parties, so that first-in-time means first-in-right.[364] However, 'priority' depends on having an effective and *enforceable* security right.[365] As a result, even though a notice has been filed, the security right under that notice only becomes *effective* once the security right has been created. But the date used to determine priority is the date on which the notice was filed, irrespective of whether this pre-dates the date on which the security agreement was concluded.

The legal effect of the provisions in article 29 of the Model Law and recommendation 77 of the UNCITRAL Guide are the same, save for one distinction. In terms of recommendation 77, a security right registered in the general registry ranks below a security right registered in a specialised registry or noted on a title certificate. Article 29 of the Model Law classifies priority competition as: the security rights obtaining third-party effectiveness due to registration;[366] security rights obtaining third-party effectiveness due to a method other than registration;[367] and the competition between security rights in the previously mentioned

362 The purpose statement to the recommendations contained in Chapter V of the UNCITRAL Recommendations.

363 Introduction of the UNCITRAL Guide para 68 at 25. Also see, recommendation 77 of the UNCITRAL Guide, and chapter V of the UNCITRAL Guide for a discussion of the detailed rules pertaining to priority. The exception under the Guide relates to the 'super-priority' afforded to acquisition security rights. Another example is a similar higher priority afforded to security rights in specific industries (eg, agricultural, as under the Australian PPSA).

364 This relies on the *prior tempore, potior jure* principle. See Chapter V of the UNCITRAL Guide paras 30 and 44.

365 Recommendation 76(*a*) of the UNCITRAL Guide.

366 Article 29(*a*) of the UNCITTAL Model Law. Priority is determined by order of registration (first-to-register priority rule), subject to the security having been created when the priority needs to be determined.

367 Article 29(*b*) of the UNCITTAL Model Law. The UNCITRAL Model Law: Guide to Enactment para 292 at 89, only refers to the alternative of 'possession', but the other methods, like 'control agreement', will

categories.[368] Accordingly, the Model Law makes no mention of a security right registered in a specialised registry or noted on a title certificate.

Priority rules which rely on subjective knowledge could result in uncertainty. Consequently, the priority rules under both the Guide and the Model Law rely exclusively on objective facts to determine priority.[369] However, there is a distinction between knowledge of the existence of a security right, and actual knowledge that a further transaction and subsequent encumbrance violates a provision of an earlier security agreement. The latter kind of knowledge is not permitted and would render the subsequent security agreement void.[370]

Unlike the UNCITRAL Guide, the Model Law does not contain a separate section addressing its interaction with insolvency law. However, article 35 of the Model Law makes it clear that it is possible for the insolvency laws of a country to afford a higher priority to a security right post-insolvency.

(b) Exceptions to the general rule

The underlying socio-economic policies of a country will typically determine the nature of priority rules which form part of its national legislative framework.[371] The ultimate goal of the Guide and Model Law (as well as of other international legal instruments) is to promote certainty and predictability for the parties so as to ensure that they are aware of the risks inherent in the secured transaction when they conclude it.[372] The UNCITRAL instruments aim to achieve certainty and predictability by applying the same priority rules consistently, irrespective of the nature of the securing asset or the type of creditor. Exceptions to the general priority rules are allowed where policy considerations necessitate an exception.

The policy considerations behind including certain exceptions relate to stimulating economic growth through business development, or rewarding creditors who advance

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equally apply. The example provided relates to the application of 'warehousing' where possession is given to a depository who agrees to hold the movable asset on behalf of the secured creditor.

368 Article 29(*c*) of the UNCITRAL Model Law. The priority is determined by what took place first, registration, or when another publicity method is used, when third-party effectiveness was achieved.

369 Chapter V of the UNCITRAL Guide para 125 at 218.

370 Recommendation 93 of the UNCITRAL Guide and art 45 of the UNCITRAL Model Law.

371 See the general introduction to Chapter V of the UNCITRAL Guide paras 1-7 on approaches of states to the policy which underlies priority rules.

372 SV Bazinas 'The influence of the UNCITRAL Legislative Guide on Secured Transactions' in F Dahan *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 45. Also see, NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 200.

acquisition finance with higher priority in order to stimulate a specific type of finance.[373] Policy-centred exceptions may relate to: (1) the priority of the security right in future assets determined by reference to the registration date, regardless of whether the security right existed on the registration date; (2) having alternative methods to create third-party effectiveness and to establish priority (eg, control);[374] (3) creating special priority rules that apply to specific transactions or specific types of asset;[375] or (4) providing preferential treatment to certain types of creditor (eg, tax collection agencies and judgment creditors).[376]

The secured creditor may subordinate the priority of its rights in favour of any present or future competing claimant without the recipient of this subordination having to be a party to the subordination agreement.[377] The subordination has no effect on the rights of the other competing claimants, and the new secured creditor steps into the shoes, so to speak, of the subordinator.

(c) Priority between the competing security rights in respect of specific assets

The date of priority in the case of future assets is calculated retrospectively from the date of registration of the notice and not from the date on which the asset actually came into existence or on which the security agreement was signed.[378] Reserving a higher priority ranking in the case of future assets has commercial merit, but the uncertainty for a potential creditor cannot be ignored. The potential creditor conducting a search on the registry cannot assume that the security right exists. There is no guarantee that a security right exists merely because a security agreement was entered into.[379] Nevertheless, as the purpose of notice-filing is to provide a 'red

373 Chapter V of the Guide para 32 at 192-193. Acquisition security rights holders may enjoy higher priority than other security right holders subject to compliance with set requirements. See the discussion of the requirements in paragraph 3.3.4.7 *infra*.

374 Registration in a special registry or notation on a title certificate – see Chapter V of the UNCITRAL Guide para 56 and recommendation 77(*a*) of the UNCITRAL Guide – ranks above any right, even an acquisition security right.

375 Chapter V of the UNCITRAL Guide para 55 at 199. In case of assets like negotiable instruments, a third a security right which become effective through possession will enjoy higher priority than a security right that became effective through registration. See Chapter V of the UNCITRAL Guide para 35 at 193.

376 See Chapter V of the UNCITRAL Guide paras 40, 90, 91 and 92 at 194, 208-209, along with recommendations 83 (preferential claims) and 84 (in respect of judgment creditors) of the UNCITRAL Guide.

377 Article 43(1) of the UNCITRAL Model Law and recommendation 94 of the UNCITRAL Guide.

378 Recommendation 99 of the UNCITRAL Guide and art 44 of the UNCITRAL Model Law. This is similar to the South African position applicable to covering bonds. See Chapter 2 paragraph 2.3.3.3(*a*) *supra*.

379 It is not recorded on the registry whether the security agreement was actually entered into. Also, the notice must correspond to the content of the security agreement. Where there is a discrepancy between the details in the notice and the security agreement, the details in the security agreement take preference.

flag' that a security right *possibly* exists, this places a burden on the creditor to make further enquiries.

In terms of article 32 of the Model Law, the competing security right in proceeds will usually have the equal priority as the original security right in the encumbered asset, subject to the security right in the proceeds complying with the general provisions on proceeds as stipulated in article 19 of the Model Law.[380] However, where the original security right is an acquisition security right, it is possible that the super-priority will not necessarily extend to the proceeds in that such an extension of super-priority depends on the type of proceeds in question.

The UNCITRAL Guide and Model Law share similar provisions regarding the priority of a security right in a subsequent mass or product.[381] Priority is determined with reference to the priority of the asset immediately before it was either commingled or included as part of the product.[382] However, the limitation of the maximum value of the security right in the Guide differs from that in the Model Law. The reason for this is that the Guide does not distinguish between the *value* or *quantity* of the assets in the case of a mass or product, while the Model Law assigns a maximum *value* in the case of a product and a maximum *quantity* in the case of commingling into a mass. Thus, where there are different elements or components with competing secured creditors in the respective elements or components, the priority is determined by first establishing the value of the element or component. The competing secured creditors in the respective components then share in the value of the *component* according to their original priority ranking. Consequently, a secured creditor with a security right in one element or component does not compete in priority ranking against a secured creditor with a security right in another element or component.

The UNCITRAL instruments also recommend special priority rules for specific types of asset. These assets include: a negotiable instrument (eg, cheques and bills of exchange); [383] negotiable document or the tangible assets covered by a negotiable document;[384] a right to

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380 This article is based on recommendation 100 of the UNCITRAL Guide.

381 Recommendations 90-92 of the UNCITRAL Guide and art 33 of the UNCITRAL Model Law. Also see the general discussion on the extension of the security right to a mass or product under paragraph 3.4.2.4 *supra*.

382 Recommendation 91 of the UNCITRAL Guide and art 33(1) of the UNCITRAL Model Law.

383 Recommendation 102 of the UNCITRAL Guide. The security right in a negotiable instrument, made effective against third parties through possession, enjoys higher priority than a security right in a negotiable instrument made effective by any other method.

384 Recommendation 108 of the UNCITRAL Guide. The security right in a negotiable document or the tangible asset covered by a negotiable document, made effective against third parties through possession, enjoys a higher priority than a security right in a negotiable document or the tangible asset covered by a negotiable document made effective by any other method.

payment of funds credited to a bank account;[385] money;[386] and a right to receive proceeds under an independent undertaking.[387]

3.3.3.9 The secured transactions regime must be facilitative not formalistic

Both the UNCITRAL Guide and the Model Law follow a facilitative rather than a formalistic approach to the regulation of secured transactions.[388] The approach is facilitative in the sense that the provisions of the UNCITRAL instruments encourage party autonomy in the case of secured transactions, while the minimum mandatory rules will ensure fairness and safeguard the interests of related parties. Also, as a result of implementing the functional approach, the recommended regime will be facilitative. The reference can be made to: (1) a formal approach (where there is a clear divide between true security rights and *quasi*-security rights); and (2) a functional approach (implementing a unitary concept of a security right or following a uniform system of rules).[389]

The UNCITRAL Guide applies to *contractually*-created security rights (the content of the right is agreed to between the parties), not rights created by operation of law.[390] Consequently, party autonomy is an important principle in the Guide and parties have the freedom to structure their agreement to meet their specific transactional needs.[391] However, there must be limits to party autonomy and the Guide includes both mandatory and non-mandatory rules to safeguard the rights of third parties.[392] The mandatory rules are the rules relating to the creation, third-party effectiveness, priority, enforcement, and a limited number

385 Recommendation 103 of the UNCITRAL Guide. A security right in a right to payment of funds credited in a bank account, made effective through control, enjoys a higher priority than such a security right made effective in any other way.

386 Recommendation 106 of the UNCITRAL Guide. A person who obtains possession of money that is subject to a security right, takes the money free from this security, except if that person has knowledge that taking the money violates a specific provision of the security agreement. This is more an exception to third-party effectiveness than a priority rule.

387 Recommendation 107 of the UNCITRAL Guide. A security right in a right to proceeds under an independent undertaking, made effective through control, enjoys a higher priority than such a security right made effective in any other way.

388 See in this regard, Introduction of the UNCITRAL Guide para 70 at 2; recommendation 10 of the UNCITRAL Guide; Chapter 1 of the UNCITRAL Guide paras 115-118 at 59-60; and art 3 of the UNCITRAL Model Law. The principle links to the key policy objective of promoting party autonomy.

389 S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 24, 32.

390 Purpose to the UNCITRAL Guide para (a). Also see, NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 95.

391 Recommendation 10 of the UNCITRAL Guide, art 3 of the UNCITRAL Model Law, and Chapter I of the UNCITRAL Model Law: Guide to Enactment para 72 at 26.

392 AM Garro 'The creation of a security right and its extension to acquisition financing devices' (2010) 15 *Unif L Rev* 375 at 384.

of rules relating to the unitary or non-unitary approach to acquisition finance. These mandatory rules, therefore, relate to the proprietary effect of the transaction for third parties and culminate in the restriction placed on party autonomy.[393] The mandatory rules are standard for all types of secured transaction.[394] Nevertheless, according to the UNCITRAL Model Law, no law should affect a security agreement in which the parties have agreed to use alternative dispute resolution mechanisms to resolve a dispute under the agreement.[395] The parties can also not waive the general standard of good faith or the requirement that they act in a commercially reasonable manner.[396]

3.3.3.10 Efficient enforcement proceedings: extrajudicial enforcement and realisation must be possible

(a) Introduction and general principles

Enforcement proceedings commence after the debtor's default[397] and fall within three categories: judicial, extrajudicial (which includes alternative dispute resolution under the UNCITRAL Model Law), or expedited judicial enforcement proceedings. The UNCITRAL instruments recommend that a secured transactions law regime should include the option of extrajudicial enforcement in addition to judicial enforcement proceedings.[398] Further, exercising one enforcement avenue should not exclude using another.[399] Consequently, the Model Law works on the assumption in the UNCITRAL Guide that maximising the flexibility of the enforcement process will result in the increased efficiency of the entire enforcement process.[400] Flexibility is embedded in the fact that: (1) the secured creditor can exercise more

393 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 120.
394 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 114.
395 Article 3(3) of the UNCITRAL Model Law.
396 The general conduct standard in respect of enforcement under the UNCITRAL Guide and the overarching principle under the UNCITRAL Model Law. The prohibition on waiving this standard is included in recommendation 132 of the UNCITRAL Guide and as a provision which may not be varied by an agreement in art 3(1) of the UNCITRAL Model Law.
397 Whether there is 'default' depends on the provisions of the security agreement and so is determined according to the law of obligations. See Chapter VIII of the UNCITRAL Guide para 11 at 277.
398 Recommendation 142 of the UNCITRAL Guide and art 73 of the UNCITRAL Model Law. See also the UNCITRAL Model Law: Guide to Enactment para 427 at 130.
399 Recommendation 143 of the UNCITRAL Guide.
400 UNCITRAL Model Law: Guide to Enactment para 423 at 129.

than one post-default right;[401] and (2) *the parties* may propose a post-default right in the security agreement,[402] thus linking back to the principle of party autonomy.

Extrajudicial enforcement proceedings extend to both extrajudicial possession of the encumbered asset *and* extrajudicial realisation (either selling the asset or the secured creditor taking it over). Extrajudicial enforcement cannot take place without sufficient notice. The idea appears to be that all interested parties must be well-informed about the enforcement measures. Extrajudicial enforcement exposes the debtor to additional risks.[403] Consequently, the Guide and Model Law add requirements that protect the debtor while also allowing an economically effective enforcement process which benefits both the creditor and debtor.[404] In any event, any post-default right must be enforced subject to the principal obligation to exercise the 'rights in good faith and in a commercially reasonable manner'.[405] The standard of commercial reasonableness appears to be wider than a duty of care, and this wider standard includes a duty on the creditor to 'fix up' the collateral before it is sold.[406]

Extrajudicial enforcement is dependent on obtaining the voluntary consent of the debtor. The general theme of extrajudicial enforcement corresponds to that of contractually agreed perfection (relating to possession of the encumbered property) and *parate executie* (concerning the disposition of the encumbered asset) known in some domestic legal frameworks.[407] Essentially, voluntary possession and disposition are possible in terms of the Guide and Model Law without court intervention, but subject to specific requirements. These requirements are aimed at providing specific safeguards to protect the debtor against prejudice. The safeguards relate to securing timely consent from the grantor (both in the security agreement and when possession takes place) as well as adequate notice to the grantor and any person that is in possession of the encumbered asset. Under the UNCITRAL instruments, all enforcement actions are preceded by adequate notice. Providing notice is an important safeguard in the case of extrajudicial enforcement, and adequate notice needs to be provided at different stages in

401 Allowed under art 72(2) of the UNCITRAL Model Law, provided the exercise of one right does not make it impossible to exercise another post-default right.

402 Article 72(1)(*b*) of the UNCITRAL Model Law allows the parties to suggest a method that is not inconsistent with the provisions of the Model Law. This creates the possibility of including an alternative dispute resolution clause as part of the security agreement.

403 One such risk is that the creditor sells the encumbered asset at a low price or one which is not market related. A further risk is undue pressure on a debt-stricken debtor to agree to extrajudicial enforcement.

404 Chapter VIII of the UNCITRAL Guide para 31 at 283-284.

405 This is the overall standard under the UNCITRAL Model Law (see art 4), but this standard only applies in respect of enforcement under the UNCITRAL Guide. See recommendation 131 and Chapter VIII of the UNCITRAL Guide para 15 at 278-279.

406 E Dirix 'Remedies of secured creditors outside insolvency' (2008) 5 *ECFR* 223 at 239.

407 See Chapter 2 paragraphs 2.4.5.3 and 2.5.8.1 *supra*.

the enforcement process. The initial default notice stipulates the intended action and execution methods that the creditor plans to implement. As a result, this notice is provided before the secured creditor obtains possession of the encumbered asset.[408] Another notice is then required once the creditor is in possession of the encumbered asset, in which case the creditor must provide advanced notice to interested parties of the possibility of extrajudicial disposition of the encumbered asset.[409]

Ultimately, it remains possible for the debtor to request relief from the courts where the secured creditor has not exercised its post-default obligations in accordance with the law or the terms of the security agreement.[410] This includes raising an objection against extrajudicial possession by the secured creditor, as well as objecting to the extrajudicial disposition of the encumbered asset.

When enforcement proceedings take place, the creditor and debtor have different priorities. For the creditor, the nature and condition of the asset will determine the action following possession (either selling the asset or taking it over to satisfy the outstanding debt). Taking possession of the collateral,[411] acquiring the 'encumbered asset in total or partial satisfaction of the secured obligation', and disposing of the asset, are distinct actions of enforcement and different principles apply to each.[412] Also, the UNCITRAL Model Law suggests that alternative dispute resolution mechanisms should be included as part of the enforcement framework.[413] A broader discussion of the different enforcement actions follows *infra*.

(b) Taking possession of the encumbered asset

The success of extrajudicial enforcement depends, first, on whether the secured creditor is able to take possession of the encumbered asset. The Guide and Model Law provide a secured creditor with an *automatic* right (ie, without any court intervention) to take possession when

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408 Chapter VIII of the UNCITRAL Guide para 46 at 289 and recommendation 147 of the UNCITRAL Guide. See also art 77 of the UNCITRAL Model Law.

409 Chapter VIII of the UNCITRAL Guide para 40 at 287. Further, where the encumbered asset is perishable or may decline rapidly in value, or it is possible to sell the asset at a recognised market, there is no need to give advance notice of disposition. See recommendation 149 of the UNCITRAL Guide.

410 See Chapter VIII of the UNCITRAL Guide para 21 at 280.

411 The automatic right is reserved in recommendation 146 of the UNCITRAL Guide.

412 Recommendation 141(*a*)-(*c*) of the UNCITRAL Guide.

413 MB Chebeane 'Alternative dispute resolution (ADR) and secured transactions' (2017) 22 *Unif L Rev* 773 at 775.

the debtor defaults under the security agreement.[414] Even though a secured creditor has an automatic right, the *method* in which possession is taken is regulated.[415]

The creditor can only take possession: (1) under the Guide, when the debtor has agreed to possession without court intervention in the *initial* security agreement, while under the Model Law the consent must be in writing and there is no mention that the consent must be in the security agreement;[416] (2) when the creditor has given the debtor, the grantor, and the person in possession or who exercises control over the asset, adequate notice of the intention to take possession of the asset without court intervention;[417] and (3) when the secured creditor attempts to take possession, the person in possession of the encumbered asset (the grantor or another) does not object.[418] Where the debtor does not consent to this voluntary process (either in the initial security agreement or later when the secured creditor attempts to take possession), the creditor has no choice but to initiate judicial enforcement proceedings. Therefore, the crux of extrajudicial possession is that possession is only possible where: (1) the debtor and creditor agreed to the process; (2) there has been adequate notice to the debtor; and (3) consent has again been obtained from the debtor *after* default (as the secured creditor must get consent from the person in possession of the encumbered asset). Enforcement is only regarded as self-help, where either the consent of the debtor has not been obtained, or where there is no court intervention. [419] Accordingly, extrajudicial possession under the Guide and Model Law does not amount to self-help.

(c) Disposing of the encumbered asset

Subject to the nature of the asset and the outcome the secured creditor intends to achieve, the creditor may decide either to dispose of the encumbered asset, lease, or licence, or to 'acquire' the encumbered asset in fulfillment of the secured obligation. The ultimate consideration for the creditor is which option will result in recovering the outstanding debt (as far as possible).

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414 Recommendation 136 of the UNCITRAL Guide and art 77(1) of the UNCITRAL Model Law.

415 As under South African law, a perfection clause contained in a pledge agreement and a general notarial bond, provide the secured creditor with a right of possession, but possession can only take place after a court order has been obtained. The order is obtained on an *ex parte* basis – ie, through an expedited judicial proceedings. See Chapter 5 paragraphs 5.4.5.4 and 5.5.4.5 *infra*.

416 Recommendation 147(*a*) of the UNCITRAL Guide and art 77(2)(*a*) of the UNCITRAL Model Law.

417 Recommendation 147(*b*) of the UNCITRAL Guide and art 77(2)(*b*) of the UNCITRAL Model Law.

418 Chapter VIII of the UNCITRAL Guide para 56 at 292 and recommendation 147(*c*) of the UNCITRAL Guide. See also art 77(2)(*c*) of the UNCITRAL Model Law.

419 See Chapter 2 paragraph 2.3.3.3(*h*) *supra*.

As regards the disposition notice, it is important to know what information the notice must include and then who must receive this notice. In terms of recommendation 148 of the UNCITRAL Guide, the secured creditor 'may select the method, manner, time, place and other aspects of disposition', subject to compliance with the 'standards of good faith and commercial reasonableness'.[420] However, under the Model Law, where the secured creditor decides to dispose of the encumbered asset, the 'method, manner, time, place and other aspects' in respect of the disposition are determined in accordance with the rules of the enacting state.[421] The Guide is also less prescriptive as regards the process and format of the notice so as to avoid the notice obligation becoming overly cumbersome or negatively impacting on the secured creditor.[422] Thus, the advanced disposition notice must provide an 'efficient, timely and reliable way' of disposition.[423] However, the Model Law is more prescriptive and includes a list of items which must appear in the notice. Article 78(5) therefore requires: (1) a description of the encumbered asset;[424] (2) a statement amount as at the moment the notice is given sufficient to satisfy not only the secured obligation, but also the interest on the outstanding amount and *reasonable* cost of enforcement at that time;[425] (3) the date of disposition; and, (4) only 'in the case of public disposition, the time, place, and manner of the intended disposition'.[426] Unfortunately, as under the UNCITRAL Guide, there is no requirement that the disposition notice must include a fair valuation of the encumbered asset.

The disposition notice must be sent to the grantor, the debtor, and any other person who must perform the secured obligation; a secured creditor who does not necessarily have a registered security right in the asset, but who has provided written notice of a right in the asset; any secured creditor who has registered a security right in the encumbered asset; and any other creditor who was in possession of the encumbered asset from whom the secured creditor took possession.[427] A creditor must give notice of the extrajudicial disposition, unless the asset is perishable, has a value that may decline rapidly, or is a type of asset that can be sold through a recognised market.[428]

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420 Chapter VIII of the UNCITRAL Guide para 15 at 278, 279.
421 Article 78(2) of the UNCITRAL Model Law.
422 Recommendation 150 of the UNCITRAL Guide.
423 Recommendation 150 of the UNCITRAL Guide.
424 It is assumed that the description must also comply with the requirements for the security agreement and the notice to be registered.
425 Determining what constitutes 'reasonable cost' is problematic as this would assume that it is either agreed cost or taxed by an appropriate authority. To determine both at this stage of enforcement is problematic.
426 These details should also be provided in the case of a private disposition.
427 Recommendation 151(*a*) of the UNCITRAL Guide and art 78(4) of the UNCITRAL Model Law.
428 Recommendation 149 of the UNCITRAL Guide and art 78(8) of the UNCITRAL Model Law.

The Model Law deals with the distribution of proceeds acquired under all methods of enforcement in article 79.[429] The enforcing creditor must deduct the reasonable cost of enforcement from the proceeds and must then discharge the relevant secured obligation.[430] Thereafter, if there is a surplus, the enforcing secured creditor must pay the other secured creditors with lower competing claims to the extent of their claims, but only where they have notified the enforcing creditor timeously of the existence of their claim. If there is a balance left, this must go to the debtor, but – although not expressly stated – the debtor, of course, remains liable for any deficit after disposition of the encumbered asset.[431]

There is another commercially viable option where the secured creditor is not immediately able to find a purchaser willing and able to purchase the encumbered asset. The secured creditor may decide to lease or license the asset while using the rental payments towards extinguishing the debt.[432] Even though the commentary to the Guide refers to this alternative, the recommendations do not specifically include this option.[433] The mandate agreement between the debtor and creditor will determine the nature of the risk associated with this alternative. In simple terms, this determines the extent to which the secured creditor is allowed carte blanche to decide on the terms of the lease or licence of the asset. For example, whether the secured creditor determines the lease or license amount (according to the market norm or the monthly repayments), to whom the asset may be leased or licensed, and the period of the lease or licence. The creditor acts as the debtor's agent. Accordingly, the secured creditor will only be able to lease or license the asset on the terms as agreed to between the creditor and debtor.

(d) Taking-over the encumbered asset

Where the creditor decides to acquire the asset in fulfilment of the secured obligation, the law must be able to draw a clear distinction between a *pactum commissorium* (forfeiture clause), prohibited under most national laws, and a *quasi*-conditional sale.[434] There are inherent risks to the secured creditor acquiring the collateral in satisfaction of the secured obligation. Hence, the debtor must still be able to decline the creditor's written offer to acquire the asset. Further,

429 The UNCITRAL Guide deals exclusively with distribution of proceeds from extrajudicial disposition in recommendations 152-155.
430 Article 78(2)(*a*) of the Model Law specifically refers to the 'reasonable cost' of enforcement.
431 Article 79(3) of the UNCITRAL Model Law.
432 Chapter VIII of the UNCITRAL Guide para 78 at 300.
433 Chapter VIII of the UNCITRAL Guide para 64 at 295.
434 See Chapter 2 paragraph 2.4.5.6 *supra*.

this conditional sale can only take place *after* default, and then only subject to specific requirements[435] under both the Guide and the Model Law.[436] These requirements again deal with what is required in a notice (the acquisition proposal) and who must receive notice of the intended takeover of the encumbered asset.

Article 80 of the Model Law contains a more comprehensive list than the Guide of what is required for the acquisition proposal. The acquisition proposal must contain the following: (1) a declaration of the amount required to satisfy the obligation at the time the proposal is made, which includes the interest and reasonable costs, as well as the amount of the secured obligation that the acquisition is proposed to satisfy;[437] (2) a declaration that the secured creditor will acquire the encumbered asset in total or only partial satisfaction of the secured obligation; (3) a pronouncement that any person with a right in the encumbered asset may terminate this enforcement; and (4) confirmation of the date on which the secured creditor will acquire the encumbered asset from the debtor.[438] Neither of the UNCITRAL instruments includes any mention that the secured creditor should include an estimate of the value of the encumbered asset. If the acquisition is to take place in a commercially reasonable manner, a valuation of the property will probably be required in any event. Accordingly, it is recommended that, in addition to the above information, the estimated value of the encumbered asset should also be included as part of the notice, if for no other reason than to avoid disputes or delays.[439]

The proposal to acquire the encumbered asset must be sent to the following parties: (1) the grantor, the debtor, and any other person who must perform the secured obligation; (2) a secured creditor who does not necessarily have a registered security right in the asset, but who has provided written notice of a right in the asset; (3) any secured creditor who has registered a security right in the encumbered asset; and (4) any other creditor who was in possession of the encumbered asset and from whom the secured creditor took possession.[440] Both the

435 Chapter VIII of the UNCITRAL Guide paras 66 and 67 at 296.
436 Article 80 of the UNCITRAL Model Law and recommendations 156-159 of the UNCITRAL Guide.
437 Recommendation 157(*b*) refers to the 'amount owed' with no reference to interest and reasonable cost. The Model Law version should be preferred, even though determining reasonable cost may be problematic pre-enforcement.
438 The last requirement is not included in the in the UNCITRAL Guide.
439 The approach followed by the OAS Model Law which requires an independent appraiser to be appointed to determine the asset's value, is the preferred approach.
440 Recommendation 157(*a*) of the UNCITRAL Guide.

UNCITRAL Guide and the Model Law require all the parties who receive a notice of such acquisition, to consent to the secured creditor's acquisition before it may take place.[441]

A business sold as a going concern – when a business is taken over – may fetch a higher return than would result from selling off the separate assets of that business. Neither the Guide nor the Model Law formally recommends this type of enforcement process.[442] The only guidance offered in the Guide is that a state should weigh the value of this type of remedy against the potential prejudice that may result.

(e) Enforcement measures concerning specific intangible assets

Specific enforcement measures apply to a security right in intangible assets in the form of either a receivable (recommendation 168), a negotiable instrument (recommendations 170 and 171), a negotiable document or the tangible assets covered by a negotiable document (recommendation 172), a right to payment of funds credited to a bank account (recommendations 173-175), and a right to receive proceeds under an independent undertaking (recommendation 176). In essence, the secured creditor would collect directly from the person who has the obligation to pay on a receivable or a negotiable instrument.[443] This person will start to pay the secured creditor directly. The secured creditor need not take any additional enforcement steps where the rights in these intangible assets have attained third-party effectiveness. The secured creditor may proceed to collect or enforce its right in respect of these assets.

(f) Alternative dispute resolution

The Model Law may have opened the door to alternative dispute resolution (ADR) mechanisms in the case of secured transactions law. Security rights are technically created through a contract, which could allow the introduction of an ADR clause as part of a security agreement. Including the ADR clause creates an opportunity for recourse to ADR in preference to formal judicial proceedings to resolve disputes in the case of secured transactions.[444]

441 Article 80(5) of the UNCITRAL Model Law and recommendation 158 of the UNCITRAL Guide.
442 Only one legal instrument analysed in this thesis recommends this enforcement measure, ie, the EBRD Model Law. See Chapter 4 paragraph 4.4.3.2(*i*) *infra* in this regard.
443 Chapter VIII of the UNCITRAL Guide para 94 at 305.
444 MB Chebeane 'Alternative dispute resolution (ADR) and secured transactions' (2017) 22 *Unif L Rev* 773 at 775.

The Model Law specifically includes the following reference to ADR in article 3: 'Nothing in this Law affects any agreement to use alternative dispute resolution, including arbitration, mediation, conciliation and online dispute resolution.' However, in all likelihood this provision refers only to ADR between the contracting parties and does not necessarily include a third party. However, the role of party autonomy as an underlying principle should be considered. Would proper notice of the ADR process to a third party be sufficient to add the third party to the ADR proceedings? Allowing ADR measures might suggest that the enforcement notice should include information to the effect that ADR is the dispute resolution method of choice and be registered on the registry to notify third parties of the intended dispute resolution mechanism. This could be regarded as a form of extrajudicial enforcement. However, if this approach is accepted, it would have to be limited to a solvent debtor as ADR clauses in a contract cannot trump the laws relating to insolvency.

3.3.3.11 There must be equal treatment of all creditors who provide credit to debtors to acquire movable assets

All credit providers must be treated alike.[445] An example of a sector known for carving out certain rights for specific creditors, is the agricultural sector. However, in keeping with the objective of equal treatment, the UNCITRAL instruments do not refer to any right exclusively reserved for this sector.

Another example of types of creditor who are potentially treated differently relates to acquisition financing. There is a disparity in legal jurisdictions regarding the special rules permitting only certain credit providers to retain the title to an asset. For example, UCC Article 9 distinguishes between two types of purchase money security interests (PMSI).[446] The first is a seller's PMSI (also referred to as 'vendor credit'), which 'is a security interest taken in collateral, to the extent that it secures all or part of its purchase price'.[447] In this instance, the vendor who sells the property provides the debtor with a period within which to repay the purchase price of the acquired property. The second type is a PMSI for lenders, namely 'a security interest taken in collateral by a person who gives value to enable the grantor to acquire

445 Introduction of the UNCITRAL Guide para 72 at 26.

446 UCC Article 9 and legal jurisdictions that follow Article 9 refer to a PMSI. A PMSI is the functional equivalent of an acquisition security right.

447 Section 14(*a*) of the Australian PPSA, where only two parties, the buyer and seller, are involved. The operation would be similar to a simple retention-of-title where no rights are ceded or assigned to a financier.

rights in the collateral to the extent that the value is applied to acquire those rights'.[448] The debtor informs the lender that the loan will be used to acquire certain property and the repayment is secured by providing the lender with a security interest in that property.

The UCC Article 9 approach should be distinguished from an acquisition security right, where, intentionally, no distinction is made between sellers and lenders so that financiers are treated equally. According to the Guide and Model Law, there should be no distinction between a credit provider acting as either a seller or a lender. The equal treatment of different types of credit provider is particularly evident in Chapter IX of the Guide dealing with acquisition finance. As a result, the purpose of Chapter IX (both in respect of option A dealing with the unitary approach, and option B dealing with non-unitary approach) is to 'provide equal treatment of all providers of acquisition financing'.[449] Unlike the UNCITRAL Guide, the Model Law does not have a separate chapter devoted exclusively to acquisition finance. Specific mention is included only in article 2 (definitions) and articles 38 to 42 dealing with aspects of the priority of acquisition security rights, which was discussed *supra*.[450] As the non-unitary approach does not form part of the UNCITRAL Model Law, all types of creditor will be treated equally in this framework. Acquisition finance forms an important part of the field of asset-based finance and is discussed extensively *infra*.

3.3.3.12 Concluding remarks

It is clear from the above discussion that the fundamental principles are intertwined into the provisions of the UNCITRAL Model Law and the recommendations to the UNCITRAL Guide. The discussion of the fundamental principles is also directly linked to the research questions posed in Chapter 1 of this thesis. Also, the fundamental principles discussed above, are the 'building blocks' used to achieve key policy objectives, the latter being more general.[451] This link between these elements is illustrated in table 3.1 *infra*.

The UNCITRAL instruments suggest that there must be equal treatment of all creditors who provide credit to debtors to acquire movable assets. This explains equal treatment of

448 Section 14(*b*) of the Australian PPSA, where three parties, the buyer, the seller and the lender, are involved.
449 The purpose statement to Chapter IX to the UNCITRAL Recommendations, concerning both the unitary and non-unitary approach).
450 See paragraph 3.4.2.8(*a*) *supra*.
451 See Chapter 1 paragraph 1.3 *supra* which discuss the inter-relationship between key objectives and fundamental principles.

acquisition financiers. Acquisition financing is discussed further in the next paragraph, following table 3.1.

	Key objectives achieved through a fundamental principle	**Research question answered through a fundamental principle**
Fundamental principles		
	Two of the key objectives are achieved by all the fundamental principles: (1) harmonisation; and (2) the provision of low-cost credit due to the enhanced availability of secured credit	
Comprehensive scope: assets, types of security device, obligations, and transactions	To allow the debtor to use the full inherent value locked in his or her assets as collateral Incorporate a non-possessory security right in all types of asset	Research question 3: How comprehensive (or inclusive) should the scope of the secured transactions law framework be?
Functional, integrated, and comprehensive approach	To allow the debtor to use the full inherent value locked in his or her assets as collateral Incorporate a non-possessory security right in all types of asset	Research question 1: Does a single legal framework result in an effective secured transactions law framework?
Allowing security rights in future assets		Research question 3: How comprehensive (or inclusive) should the scope of the secured transactions law framework be?
Allowing security rights over proceeds of encumbered assets	To allow the debtor to use the full inherent value locked in his or her assets as collateral Incorporate a non-possessory security right in all types of asset	Research question 3: How comprehensive (or inclusive) should the scope of the secured transactions law framework be?
A clear distinction between security rights being effective: *inter partes* (creation) or against third parties (third-party effectiveness)	A simple, yet efficient way of creating a security right	Research question 2: Should the method of used to create a security right be revised?
Establishing a general security rights registry	To achieve certainty and transparency	Research question 4: What is the best method to achieve third-party effectiveness?
It must be possible to take multiple security rights in the same asset	To allow the debtor to use the full inherent value	Research question 2: Should the method of used to create a security right be revised?

	locked in his or her assets as collateral Incorporate a non-possessory security right in all types of asset	
Priority: clear and detailed rules determined on a temporal basis		Research question 5: How predictable and transparent are the current priority rules?
The secured transactions regime must be facilitative not formalistic		Research question 1: Does a single legal framework result in an effective secured transactions law framework?
Efficient enforcement proceedings: extrajudicial enforcement and realisation must be possible	To include efficient enforcement measures as part of the framework.	Research question 6: Is the current South African legal framework for the *enforcement* of creditors' security rights the most efficient option?
There must be equal treatment of all creditors who provide credit to debtors to acquire movable assets	To balance the interest of the persons who form part of the secured transaction	Research question 7: Should there be equal treatment of all creditors providing debtors with credit to acquire movable assets?

Table 3.1 Interrelationship between the key objectives and fundamental principles contained in the UNCITRAL instruments and the research questions of this study.

3.3.4 Acquisition financing under the UNCITRAL framework

3.3.4.1 Introduction to the concept of acquisition finance

The law behind acquisition financing originated from contractual practices that courts recognised as commercial practices. In this respect, the law was adapted to achieve a commercial purpose. Central to an acquisition finance transaction is that the seller or lessor retains a right or title in the specific movable asset, usually inventory or equipment, resulting from the creditor extending credit.[452] However, this suspension of the transfer of the ownership (until a suspensive condition is met) derives from an agreement.[453] Accordingly, the reservation of 'title' (or ownership) is used to secure the performance of the contractual obligations. Classic examples of title-based security devices include retention-of-title and financial leases. Domestic law may recognise acquisition financing devices in the form of hire-purchase agreements or instalment sales. Whatever the label assigned, the important consideration is that title (or ownership) is normally used to secure the performance of an obligation (either just the

452 This is where the hostility in some jurisdictions originates as the right is usually to retain title to the asset. Especially in civil-law countries, there is only one form of ownership which is transferred in a set manner. Creating the possibility that ownership may be transferred contractually, is problematic.

453 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 228.

financial contractual obligation or any contractual obligation). The type of acquisition finance device used may either relate to seller-based acquisition finance, where the finance originates from the seller of the movable property,[454] or to lender-based acquisition finance, where the finance originates from somebody besides the seller of the movable property.[455]

The term 'acquisition security right' is not used in all legal frameworks. Other legal instruments contain functional equivalents to an acquisition security right, such as the acquisition security interest in the OAS Model Law[456] and the unpaid vendor's charge under the EBRD Model Law on Secured Transactions (the EBRD Model Law).[457]

The modern approach to acquisition financing is either: (1) to classify all types of security interests under acquisition financing as an acquisition security right or a PMSI;[458] or (2) to keep the separate labels for title-based security devices, but use a functional approach so that these devices are treated uniformly (uniform system of rules apply). These distinct approaches resulted in the recommendation of a unitary or non-unitary approach to acquisition finance followed by the UNCITRAL Guide, which is discussed next. Conversely, this distinction is not made in the UNCITRAL Model Law.

3.3.4.2 Introduction to acquisition financing

The legal nature of title-based security devices remains a contentious issue. As a result, acquisition finance devices were one of the aspects that resulted in an extensive debate in earlier drafts of the Guide. Accordingly, the final version is a product of an 'elaborate attempt at compromise'.[459] The compromise was to introduce an intricate set of alternative rules, with the foundation in a choice between a unitary or non-unitary approach to acquisition finance.[460] Providing these alternatives is a 'subtle twist' to the functional approach originally introduced in UCC Article 9.[461] Even though the effort to provide a compromise must be commended,

454 Retention-of-title accompanies seller-based acquisition finance.
455 A financial lease is associated with lender-based acquisition finance.
456 See Chapter 4 paragraph 4.3.3.7 *infra*.
457 See Chapter 4 paragraph 4.2.3.3(*a*) *infra*.
458 UCC Article 9 and legal jurisdictions that follow Article 9, refer to a PMSI. A PMSI is the functional equivalent of an acquisition security right.
459 AH Raymond 'Cross-border secured transactions: ongoing issues and possible solutions' (2011) 87 *Elon Law Review* 87 at 100.
460 Recommendations 9 explains how the functional approach should be implemented in case of acquisition financing.
461 G McCormack 'American private law writ large? The UNCITRAL Secured Transactions Guide' (2011) 60 *Int'l & Comp L Q* 597 at 623. See also NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 185 and 243.

Raymond argues that this elaborate attempt will add to the confusion already rife within this area of secured transactions law.[462] Importantly, the UNCITRAL Model Law, which succeeded the UNCITRAL Guide, contains no reference to the dual system for acquisition finance. Nevertheless, this compromise must be seen within the context of the Guide's key policy objectives of harmonisation and increased flexibility. The choice regarding which option to integrate as part of a domestic framework largely depends on how each option will potentially integrate with the law of sale and lease of a particular country.[463]

An 'acquisition security right' is essentially a type of security right where all rules that apply to normal security rights apply equally to an acquisition security right. However, in addition to the usual rules which will apply to a regular security right, there are additional provisions that apply exclusively to this *species* of security right.[464] The Guide defines an acquisition secured creditor and acquisition security with reference to the unitary or non-unitary approach. An acquisition security right in terms of the Guide is

> '…a *security right* in a tangible asset (other than a negotiable instrument or negotiable document) that secures the obligation to pay any *unpaid portion of the purchase price* of the asset or *an obligation incurred or credit otherwise provided* to enable the grantor to *acquire the asset*. An acquisition security right need not be denominated as such. Under the unitary approach, the term includes a right that is a retention-of-title right or a financial lease right (terms used in the context of the non-unitary approach)' (emphasis added).[465]

An acquisition secured creditor would then be:

> '…a secured creditor that has an acquisition security right. In the context of the unitary approach, the term includes a retention-of-title seller or financial lessor (terms used in the context of the non-unitary approach).'[466]

Conversely, the definition suggested under the Model Law makes no reference to a right that is a retention-of-title right or a financial lease right, or to a retention-of-title seller or

462 AH Raymond 'Cross-border secured transactions: ongoing issues and possible solutions' (2011) 87 *Elon Law Review* 87 at 100 and NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 137 where the authors refer to acquisition financing devices as 'a significantly sensitive area of secured transactions law'.

463 Chapter IX of the UNCITRAL Guide para 77 at 337.

464 Chapter IX of the UNCITRAL Guide para 57 at 332

465 Glossary included in the Introduction to the UNCITRAL Guide para 20 at 6.

466 Glossary included in the Introduction to the UNCITRAL Guide para 20 at 6.

financial lessor, as the Model Law does not recommend a non-unitary approach to acquisition financing.[467]

Essentially, a security device will qualify as an acquisition finance security right where the movable purchased is used as security for repaying the amount obtained to purchase that asset.[468] The nature of the debtor's obligation secured by the acquisition security right is not limited to a financial obligation (hence the payment of the purchase price) but also covers other obligations incurred through the financing agreement. Further, the right used as security does refers not only to ownership in the general sense, but also to a right in an asset that is the economic equivalent of ownership.[469] Security devices that comply with the above definition include a financial lease and a retention-of-title which share the same economic function: to secure the repayment obligation, with the securing asset having been bought using advanced funds.[470]

3.3.4.3 Unitary or non-unitary approach: application of the functional approach

The Guide is arranged in such a manner that the two approaches, unitary and non-unitary, arguably achieve functionally equivalent results.[471] However, irrespective of whether a country implements the unitary or non-unitary approach, the Guide aims to afford equal treatment to all credit providers who provide functionally equivalent security devices.[472] 'Equal treatment' is also an objective of the Model Law. Equal treatment does not mean that all creditors are treated *exactly* the same. Accordingly, acquisition finance creditors are treated equally up to a point as the Guide and Model Law provide for the creation of specific exceptions.

(a) Unitary approach

Under the unitary approach, any right that complies with the definition of an acquisition security right mentioned above is reclassified as such and treated as an acquisition security right. Application of the unitary approach means that all acquisition finance devices are treated

467 Article 2(*a*) of the UNCITRAL Model Law.
468 Chapter IX of the UNCITRAL Guide para 3 at 319.
469 Chapter IX of the UNCITRAL Guide para 11 at 321 refers to the example of leases.
470 Chapter IX of the UNCITRAL Guide para 8 at 320.
471 Arguably, the provisions of the OAS Model Law provided the inspiration for Guide's non-unitary approach. This assumption is revisited after the discussion of the OAS Model Law in Chapter 4 paragraph 4.3.3 *infra*.
472 Recommendation 9 of the UNCITRAL Guide and the 'Purpose' of the provisions on acquisition security rights as introduction to the recommendations.

the same as any other security device, unless specifically stated otherwise regardless of the form the device takes.[473] The unitary option is suggested for countries where extensive legal reform has already taken place, and where that country wishes to implement only minor changes to the framework. Recommendations 178 to 186 of the Guide apply when legal jurisdictions adopt a unitary approach. The Model Law recommends implementing only the unitary approach, and its provisions (arts 38 to 42) correspond to recommendations in the Guide as regards the unitary approach.

(b) Non-unitary approach: restricted to the Guide

The non-unitary option is suggested for countries embarking on reform, and even more so for civil-law jurisdictions.[474] Recommendations 187 to 202 of the Guide apply to legal jurisdictions which elect to follow a non-unitary approach.

Applying the functional approach to the non-unitary approach entails that the separate labels of, for example, a retention-of-title and a financial lease, are retained, but a uniform legal framework is applied to all acquisition-*type* financing devices and retention-of-title and financial lease devices.[475] Put simply, the rights in terms of a retention-of-title and a financial lease are mentioned separately from acquisition security rights, but the legal consequence that flow from the rights under these title-based devices, are the functional equivalent of the legal consequences flowing from other acquisition security rights.

On face value, rights under retentions-of-title and financial leases comply with the above definition of an acquisition security right, save that these rights remain *quasi*-security rights as they are specifically excluded from the Guide's definition for a security right.[476] In essence, where the Guide's provisions relate to a security right, the provisions would not apply to the rights under a retention-of-title or a financial lease unless the Guide specifically states that the provision should also apply to the rights under a retention-of-title or a financial lease.[477] Essentially, an acquisition secured creditor must have rights similar to those held by a retention-of-title creditor. This means that the right of an acquisition secured creditor must be similar to

473 Recommendation 178 of the UNCITRAL Guide and Chapter IX of the UNCITRAL Guide para 78 at 337.
474 G McCormack 'American private law writ large? The UNCITRAL Secured Transactions Guide' (2011) 60 (3) *Int'l & Comp L Q* 597 at 624.
475 This means that, as far as possible, the same rules on creation, third-party effectiveness, enforcement, and priority apply in both instances.
476 See paragraph 3.3.3.1(*a*) *supra* for a definition of a security right under the Guide.
477 Chapter IX of the UNCITRAL Guide para 81 at 338.

that which an ordinary owner would have. On a practical level, following the non-unitary approach entails that the current provisions relating to retention-of-title and financial lease devices are adapted to resemble those provisions governing the acquisition security rights or *vice versa*.[478]

The discussion in the Guide of the non-unitary approach remains confusing, and it is difficult to understand how the concept of ownership and the legal consequences that follow the reservation of ownership (either through a retention-of-title or a financial lease), can be treated as functionally equivalent to the legal consequences associated with a conventional security right. The Guide prefers an approach where the rules relating to a retention-of-title creditor or a lessor under a financial lease, are adapted to be similar to the rules applicable to an acquisition secured creditor.[479] This may entail changing the rules that apply to 'ownership', which could prove difficult where a legal jurisdiction does not recognise the concept of 'split ownership'. The provisions relating to retentions-of-title and financial leases are discussed further *infra*.

3.3.4.4 A retention-of-title and a financial lease as acquisition finance devices

As already mentioned, legal jurisdictions deal with title-based security devices in different ways. Accordingly, the reclassification of certain title-based devices as an acquisition security right will not be supported by all legal jurisdictions.[480] The different treatment of title-based devices among legal jurisdictions depends on the following factors: the general classification of the rights either as security rights or *quasi*-security rights;[481] the requirements for creation and third-party effect – whether or not registration of these rights is required; and whether or not these acquisition security rights attract super-priority above other security rights.[482] The Guide does not deal directly with the principles concerning the passing of ownership in the case of a reservation-of-ownership. It is left to the domestic legislator to decide how to deal with the concept of ownership and the rights associated with it. The Guide suggests that the

478 Chapter IX of the UNCITRAL Guide paras 81, 82 at 338.
479 Chapter IX of the UNCITRAL Guide para 82 at 338, 339.
480 AM Garro 'The creation of a security right and its extension to acquisition financing devices' (2010) 15 *Unif L Rev* 375 at 388.
481 Under English law this right is not treated as a security right. See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 227.
482 The term 'super-priority' entails that irrespective of when a non-acquisition security right was registered or attained third-party effect, an acquisition security right will always rank above a non-acquisition security right. Nevertheless, security rights registered in a specialised register, or where title is noted, still outrank any other right, including an acquisition security right.

law which governs acquisition financing must lead to functionally equivalent results, irrespective of the fact that the creditor holds a retention-of-title right, a financial lease right, or an acquisition security right.[483]

The terms 'retention-of-title right' and 'financial lease right' are used exclusively in respect of the non-unitary approach option in the Guide and the meaning assigned to each device applies within the context of the Guide.[484] A retention-of-title right would be the seller's right in the movable asset originating from a security agreement with the buyer, where ownership is only transferred from the seller to the buyer once the 'unpaid portion of the purchase price' has been paid (hence a conditional sale).[485] Accordingly, retention-of-title is an example of a seller-based acquisition finance device.[486] In turn, a financial lease right is the lessor's right in the movable asset that forms the object of a lease agreement, where potential outcomes resulting from this lease agreement include: (1) that the lessee automatically becomes the owner of the object she is leasing; (2) the lessee can become the owner of the asset simply by paying a nominal price for it; or (3) the asset does not have more than a nominal residual value. Essentially, the lease only qualifies as an acquisition financing transaction where the asset is used for the majority of asset's 'useful life' exchanged for notional rental payments, which if added together, represent the economic equivalent of the purchase price of the asset.[487] The definition under the Guide differs from what is traditionally regarded as a financial lease. Under a traditional financial lease, it is not the intention that ownership will shift to the lessee. As soon as there is an option that ownership can shift, the lease would amount to a hire-purchase agreement. Accordingly, the financial lease right under the Guide includes the rights under a hire-purchase agreement (effectively a lease agreement with the option to purchase the encumbered asset) if it meets the requirements for a financial lease.[488] A financial lease is an example of a lender-based acquisition finance device.[489]

Retention-of-title is commonly used where the title to an asset is used to secure the payment of the purchase price of that asset.[490] The different types of retention-of-title clause

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483 Recommendation 188 of the UNCITRAL Guide.
484 See Chapter 2.6 for the discussion of title-based security devices under the South African framework.
485 The approach under the Guide applies to the simple version of a retention-of-title device. See Chapter 2 paragraph 2.6.1.1 where different types of retention-of-title clause are discussed.
486 Chapter IX of the UNCITRAL Guide paras 46-51 at 329, 330.
487 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 232.
488 SV Bazinas 'Acquisition financing under the UNCITRAL Legislative Guide on Secured Transactions' (2011) 16 *Unif L Rev* 483 at 487.
489 Chapter IX of the UNCITRAL Guide paras 52-55 at 330, 331.
490 Chapter IX of the UNCITRAL Guide para 26 at 324.

have already been discussed.[491] In most legal jurisdictions there are limits on the scope of the security right under a retention-of-title. Firstly, the security right can usually only be held in a tangible asset and not in receivables flowing from the asset.[492] Further, the retention of ownership exists as long as the original identity of the product remains (so it excludes security rights in a mass or products).[493] The right under the retention-of-title only secures the sale price and no other amounts resulting from the sale that might also be owed to the seller.[494]

A financial lease agreement can be structured to be the functional equivalent of a retention-of-title device.[495] However, the distinction is that with a lease, it is not certain that ownership will transfer to the buyer at the end of the lease period and the lessee only receives use of the asset against payment of a monthly rental amount. When the lease period comes to an end, the lessee has the alternative to either purchase the asset at a nominal value (equal to the residual that remains at the end of the finance term), or extend the lease period and refinance the residual amount.[496] In any event, the initial lease period generally covers, more or less, the useful life cycle of the equipment or another asset. A lease agreement is not suitable when purchasing revolving assets like inventory, but it is particularly relevant in the case of equipment.

It has been mentioned previously that, in its application to acquisition finance, the Guide attempts to implement a 'subtle twist' to the functional approach. This approach boils down to following a uniform approach as far as possible[497] as regards creation, third-party effectiveness, priority, and enforcement.[498] These aspects, as applicable to the uniform system, are explored further in the following paragraphs.

3.3.4.5 Creation of an acquisition security right and rights in terms of a retention-of-title clause or lease agreement

Acquisition security rights and other security rights are created in the same manner under the Guide and Model Law – through the conclusion of a security agreement. Nevertheless, it has

491 Chapter 2 paragraph 2.6.1 *supra*.
492 Chapter IX of the UNCITRAL Guide para 28 at 324.
493 Chapter IX of the UNCITRAL Guide para 28 at 324. Accordingly, the extended version of a retention-of-title is not recommended.
494 Chapter IX of the UNCITRAL Guide para 28 at 324.
495 Chapter IX of the UNCITRAL Guide para 31 at 325.
496 Chapter IX of the UNCITRAL Guide para 31 at 325.
497 Meaning, how far the rules which apply to security rights can also apply to these *quasi*-security rights.
498 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 233.

been established that a right under a retention-of-title clause or financial lease agreement is excluded from the definition of a security right under the application of the non-unitary approach. As a result of applying the functional approach, these rights must be created in the same manner as other security right under the UNCITRAL instruments. However, as regards a retention-of-title clause or financial lease agreement, 'creation' does not convey how the seller and lessee acquire the rights under these security devices.[499] There are potentially three issues to using the functional approach to create the different rights: (1) whether the real agreement must be in writing; (2) where only one type of ownership is known; and (3) that traditionally, creation and third-party effectiveness take place when the agreement is concluded without the need for publicity of the right under the agreement.

The general rule is that the security agreement which creates the security right must be in writing unless an oral agreement is supplemented by the secured creditor's possession of the encumbered asset. As an acquisition security right is a *species* of security right (in the unitary approach under the Guide), this general rule applies to it as well. However, whether a retention-of-title or financial lease agreement must be in writing, depends on national law.[500]

Indeed, it is more accurate to say that the seller under the retention-of-title device and the lessor under the financial lease device, 'acquire' their respective rights.[501] Consequently, the seller and lessor continue to assert their ownership in terms of the security agreement, but these rights are not 'created' through the security agreement within the meaning of the Guide.[502] Nevertheless, the Guide recommends that 'where the buyer under a retention-of-title agreement acquires an expectancy of ownership' (as is the case under German law), a type of bifurcate (or split) ownership comes into existence.[503] Where there is this type of 'split' ownership, it is theoretically possible to refer to the 'creation of this right', as it is incorrect to classify the rights that remain with the seller as 'traditional ownership'.[504] As a result, where a legal jurisdiction does not recognise a bifurcate type of ownership, it would be a stretch to fully equate the 'creation of a security right' (within the meaning of the Guide) with 'acquire' (within the context above).

499 Chapter IX of the UNCITRAL Guide para 85 at 339.
500 Chapter IX of the UNCITRAL Guide para 87 at 340.
501 Chapter IX of the UNCITRAL Guide para 85 at 339.
502 Chapter IX of the UNCITRAL Guide para 85 at 340.
503 Chapter IX of the UNCITRAL Guide para 85 at 340.
504 Chapter IX of the UNCITRAL Guide para 85 at 340.

3.3.4.6 Effectiveness of an acquisition security right against third parties

(a) Unitary approach: third-party effectiveness

In terms of recommendation 178, the provisions on creation, third-party effectiveness, and enforcement that apply to ordinary security rights, apply equally to acquisition security rights, excluding an acquisition security right in consumer goods.[505] Consequently, an acquisition security right becomes effective against third-parties under the same circumstances as any other security right under the Guide.[506] Further, as, in terms of the Model Law, an acquisition security right qualifies as a security right, the provisions which apply to ordinary security rights, apply equally to acquisition security rights.

However, recommendation 180 (dealing with the priority of an acquisition security right) is also relevant to when this right becomes effective against third parties. The Guide allows a grace period after the creation of the acquisition security right within which the right is valid against a third party *without* registration.[507]

(b) Non-unitary approach: third-party effectiveness: restricted to the Guide

Where the non-unitary approach applies (ie, as a result of applying the functional approach), the rights under a retention-of-title or financial lease agreement, must also acquire third-party effect in a manner equivalent to acquisition security rights. In theory, this means that both types of right need to be registered. Further, the influence of having a suspensive condition – which reserves the passing of ownership in the case of retention-of-title or financial lease agreement – also plays a role. This goes back to the nature of the rights of the seller and buyer. Another point to consider is whether rights in certain types of asset, for example, inventory, should be treated differently because it is subject to requirements (in addition to registration) unique to this type of asset. Inventory involves greater risk as the asset actually does not remain in the debtor's estate and the purpose is to sell it. Other types of asset, equipment, for example, increase the value of the debtor's estate so balancing the risk that the asset may stay in the estate.[508]

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505 An acquisition security right in consumer goods, will have priority over any non-acquisition security right already created. See recommendation 179 of the UNCITRAL Guide.

506 See the requirements under paragraph 3.3.3.5 *supra*.

507 Recommendation 180 suggests a short period of 20 or 30 days. The EBRD Model Law allows for a grace period of six months after creation of the unpaid vendor's charge.

508 MG Bridge *et al* 'Formalism, functionalism, and understanding the law of secured transactions' (1999) 44 *McGill LJ* 567 at 597.

As under the unitary approach, the UNCITRAL Guide allows a grace period after the buyer or lessee has obtained the asset, within which this right is valid against a third party *without* registration.[509] Despite this grace period, the rights under a retention-of-title or financial lease eventually need to be registered. Conversely, some countries do not require registration for the rights under a retention-of-title or a financial lease to become effective against third parties. Also, where a country does not recognise a bifurcate type of ownership, the effectiveness against third parties depends on whether the parties have complied with the rules relating to the transfer of ownership, and registration of the right will be irrelevant.

The Guide creates alternative approaches to dealing with rights linked to inventory as the encumbered asset. The alternate approach is evident in the alternatives to recommendation 192. In alternative B, inventory is treated no differently than other assets, and a retention-of-title right or a financial lease right in a movable asset (excluding consumer goods) becomes effective against third parties either: (1) where the seller or lessor retains possession of the asset; or (2) a notice relating to this right is registered (notice-filing takes place) in a general security rights registry by a certain date *after* the buyer or lessee has obtained possession of the asset.[510] Alternative B avoids delays in the delivery of inventory, which can cause financial loss for the seller and an inability to use the asset on the part of the debtor.[511] However, where the notice is not registered within the grace period after the debtor has obtained possession, the retention-of-title right or financial lease right will not be effective against a third party.[512] This means that the holder of these rights will be in a weaker position than would have been the case in some jurisdictions that do not require registration and where the right of ownership itself is the security.

In contrast, alternative A draws a distinction between inventory and other acquisition finance assets. In the case of inventory under alternative A, the seller or lessor must take certain additional steps before the buyer or lessee can obtain possession of the inventory and for the retention-of-title right or financial lease right to be effective against third parties. First, a notice relating to these rights must be registered in the general security rights registry. Secondly, *all* secured creditors with an earlier *registered* non-acquisition security right in the inventory of

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509 Both alternatives to recommendations 180 (the unitary approach) and 192 (the non-unitary approach) suggest a short period such as 20 or 30 days. The EBRD Model Law allows for a grace period of six months after creation which is too long.

510 The Guide suggests a short period, such as 20 or 30 days (see alternative B to recommendation 192(*a*)(ii) of the UNCITRAL Guide).

511 SV Bazinas 'Acquisition financing under the UNCITRAL Legislative Guide on Secured Transactions' (2011) 16 *Unif L Rev* 483 at 491.

512 Recommendation 194 of the UNCITRAL Guide.

the *same kind*, in which buyer or lessee intends to claim a retention-of-title right or a financial lease right, must be informed by the seller or lessor of the intention to register such a right in the inventory. Thirdly, inventory must be sufficiently described to allow it – as an object under the retention-of-title or lease – to be identified. The notice requirement is cumbersome and probably anti-competitive to some extent, as the practical effect is that a notice must be sent to *all* other suppliers that supply similar inventory to the buyer or lessee. However, this notice need only be sent once and remains valid for multiple transactions.[513]

Recommendation 193 allows a single notice to be registered in respect of multiple transactions between the same parties, irrespective of whether those transactions are concluded before or after registration. This recommendation makes it possible for the security right to exist in respect of revolving assets.

The Guide also recommends that the seller (who holds a retention-of-title right) and the lessor (who holds a financial lease right) in the encumbered asset, should acquire a *security right* in the proceeds from that asset.[514] Therefore, the right in the proceeds qualifies as a security right under the Guide, but the retention-of-title right and the financial lease right do not. Where such proceeds include 'money, receivables, negotiable instruments, or rights to payment of funds credited to a bank account', the impression is created that notice-filing need not take place before the security right is effective against third parties.[515] This does appear strange as a security right under the Guide requires publicity to be effective against a third party. In terms of recommendation 198(*a*), all other proceeds not included in the above list, must be described generically in the notice filed in respect of the retention-of-title right or the financial lease right. Further, where the proceeds have neither been listed in the categories mentioned directly above, nor registered in the generic manner mentioned above, this security right in the proceeds remains effective against third parties for a limited time period. After that, publicity of the security right in the proceeds must take place using one of the publicity methods recommended by the Guide.[516]

3.3.4.7 Priority under acquisition finance

513 Alternative A to recommendation 192(*c*) of the UNCITRAL Guide.
514 Recommendation 197 of the UNCITRAL Guide.
515 Recommendation 198 of the UNCITRAL Guide.
516 This includes notice-filing, registration in a specialized registry, or notation on a title certificated, possession, or control.

The UNCITRAL Guide and UNCITRAL Model Law create a higher priority for an acquisition security right than for a non-acquisition security right, albeit with one exception under the Guide. Where security right or other right is either registered in a specialised registry, or noted on a title certificate (as contained in the Guide), only this category of non-acquisition security right ranks higher in priority than any acquisition security right.[517]

The higher priority of an acquisition security right exists even if the non-acquisition security right (excluding a security right in consumer goods) was registered *before* the acquisition security right. In so doing it avoids the situational monopoly created by a floating-type security device. This higher priority is referred to as 'super-priority' within the PMSI context under UCC Article 9 and legal jurisdictions based on Article 9. As the Guide follows UCC Article 9, the term 'super-priority' is also extended to the discussion *infra*.

(a) A unitary approach to priority

The Guide (in terms of recommendation 180), and the Model Law (in terms of article 38),[518] both carved out alternatives concerning inventory. The alternatives under recommendation 180, distinguish between inventory and other assets (the recommendation does not mention other assets by name). The alternatives under the Model Law draw a distinction between inventory and equipment (so the Model Law assumes that 'other assets' are most likely equipment). Also, the reference to the intellectual property rights or rights of a licensee under an intellectual-property licence is reference to the intellectual property equivalent of either the equipment, inventory, or consumer goods mentioned in the context of article 38 of the Model Law.[519] Each alternative to making this distinction between types of movable property is discussed below.

Under alternative B to recommendation 180 of the UNCITRAL Guide, inventory is treated no differently than other assets. Super-priority applies as long as the acquisition secured creditor either retains possession[520] or, in the case of a non-possessory acquisition security right, the grantor of the acquisition security right registered a notice within a short time after

517 Recommendation 181 of the UNCITRAL Guide.
518 Other than recommendation 180 to the UNCITRAL Guide, art 38 of the UNCITRAL Model Law also follows the provisions of recommendation 247 of the UNCITRAL Intellectual Property Supplement.
519 UNCITRAL Model Law: Guide to Enactment para 322 at 97
520 This is not commercially practical unless possession could be through warehousing, where a third-party collects an asset they have bought from the buyer directly from the warehouse.

she obtained possession of the asset.[521] Option B to article 38(1) of the Model Law is similar to the alternative B of recommendation 180. Nevertheless, article 38 specifically list inventory, equipment, and the intellectual equivalents of inventory and equipment, thus not merely referring to 'a tangible asset other than consumer goods' as per the Guide.

Option A of article 38 of the Model Law and alternative A to recommendation 180 of the Guide are similar in most respects. Nevertheless, there are some differences which are pointed out below. In both versions, the rules applicable to inventory and equipment (or other assets apart from inventory under the Guide) are different (thus split into separate paragraphs). In respect of equipment (or other assets besides inventory under the Guide), it is possible to register a notice *after* the grantor has obtained possession, and it also not required to notify other secured creditors of the intention to acquire an acquisition security right. Accordingly, the acquisition secured creditor, acquires super-priority either where: (1) the acquisition secured creditor retains possession of the equipment (which option is not commercially sound); or (2) where the *grantor* obtains possession (or, in the case of the Model Law, the agreement for the sale or licensing of the intellectual property equivalent has been concluded), that a notice must be filed within a prescribed time *after* the possession (or conclusion of the agreement under the Model Law) has taken place.[522]

Alternative A to recommendation 180 – more specifically paragraph (*b*) of the Guide and article 38(2) of the Model Law – suggests that an acquisition security right in inventory should be accorded super-priority, but subject to one of two scenarios that must be present.[523] Firstly, the acquisition secured creditor must retain possession of the inventory (which option holds less commercial value). Secondly, the alternative where the inventory is delivered to the grantor requires two additional actions from the creditor that must take place before the grantor obtains possession or delivery (different terms are used in the instruments). The Guide refers to the asset which is *delivered* to the grantor, while the Model Law refers to the grantor obtaining *possession* or that the agreements for the sale or licensing of the intellectual property have been concluded (as per the Model Law).[524] The first additional action requires that a notice must be registered in the general security rights registry (or registry defined under the Model Law). The

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521 The suggestion is 20 to 30 days. UCC Article 9 uses 20 days.

522 Option A to art 38(1)(*a*) and (*b*) of the UNCITRAL Model Law, and alternative A to recommendation 180(*a*)(i) and (iii).

523 In terms of the Model Law the reference is to 'inventory and intellectual property or rights of a licensee under a license of intellectual property' – the latter being the intellectual property equivalent of inventory.

524 Delivery is regarded as the method used to obtain possession. Arguably, using either possession or delivery will have the same legal outcome.

second action requires that a secured creditor with an earlier-*registered* non-acquisition security right in inventory (or the intellectual property equivalent under the Model Law) of the *same kind*, must receive notice from the acquisition secured creditor that she has or intends to acquire an acquisition security right.[525] The Guide and Model Law differ in respect of the standard in terms of which the inventory (or the intellectual property equivalent under the Model Law) must be described. The Model Law requires an asset description which 'reasonably allow[s] its identification',[526] while the Guide simply refers to the inventory being described so that the non-acquisition secured creditor can identify the specific inventory.[527]

The alternative A recommendation 180 (the Guide) and option A to article 38 (the Model Law), may be more time-consuming, but they provide adequate notice to all involved parties as regards the additional risks associated with using inventory as the securing asset. However, one notice may cover multiple transactions and, as the inventory is 'of the same kind', the secured creditor need only register a notice every few years.[528] The fact that notice must be provided does not imply that the non-acquisition creditor must actually *consent* to the super-priority for it to be effective; she need only be notified. Determining priority between different acquisition security rights depends on when the notice was filed, but is subject to compliance with the notice requirements in recommendation 180 above.

(b) Non-unitary approach to priority: restricted to the Guide

The Guide does not include a separate recommendation dealing with priority under the non-unitary approach, unlike the information in recommendation 180 concerning the unitary approach.

3.3.4.8 Priority of security rights in proceeds resulting from the acquisition finance asset

An acquisition security right is a security right, so the secured creditor also has a security right in the asset's proceeds.[529] However, there are circumstances when the acquisition security right

525 These are also the requirements in UCC Article 9. See HC Sigman 'Perfection and priority of security rights' (2008) 5 *ECFR* 143 at 163.
526 Article 38(2)(*a*)(iii) of the UNCITRAL Model Law. This standard is preferred in line with the general asset description standard under both instruments.
527 Recommendation 180(*b*)(ii) of the UNCITRAL Guide.
528 The Guide appears to follow the five-year renewal period of UCC Article 9.
529 See paragraph 3.3.3.4 *supra* concerning the general provisions related to proceeds.

in the proceeds will not enjoy super-priority over a non-acquisition security right. There may be instances, depending on the nature of the asset (eg, inventory) or the type of proceeds in question (eg, receivables), where the super-priority which existed in the encumbered asset, extends to the proceeds from this asset subject to the acquisition secured creditor having taken certain additional steps.

The drafters of the Guide were conscious of the practical implication of extending super-priority to proceeds specifically resulting from inventory (usually in the form of receivables). The UCC Article 9 approach is simple in that a super-priority ranking extends only to 'identifiable cash proceeds' resulting from the sale of inventory.[530] Accordingly, the Guide included the UCC Article 9 approach to proceeds resulting from inventory, as alternative A to recommendation 185. As a result, the unitary approach is found in recommendation 185 and the non-unitary approach in recommendations 197 and 199.

(a) Unitary approach

Recommendation 185 of the UNCITRAL Guide and article 41 of the UNCITRAL Model Law concern the priority of security right in respect of proceeds. The distinction between option/alternative A and B again relates to proceeds arising from certain types of asset, which in the main are receivables in case of inventory, and whether the super-priority for the acquisition security right in the principal asset should extend to certain types of proceeds. Under alternative A to recommendation 185 of the Guide and option A to article 41 of the Model Law, the priority of the acquisition security right in the proceeds – excluding inventory which in turn includes the intellectual-property equivalent of inventory under the Model Law – and consumer goods, is the same as the acquisition security right in the principal encumbered asset. Accordingly, the acquisition security right in the proceeds resulting from assets which are not consumer goods or inventory, also enjoys super-priority (priority above other non-acquisition financiers).

However, this super-priority in respect of inventory (and the intellectual property equivalent of inventory in terms of the Model Law) can only extend to the proceeds where the acquisition creditor has taken certain additional steps. In this regard, the creditor must, as

530 § 9-312(3) of the UCC Article 9. Also see the discussion of this provision in N Joubert 'Verlengde eiendomsvoorbehoud en boekskuldfinansiering' 1988 *TSAR* 57 at 66 and reference to the practical decision to favour financiers of receivables above financiers of inventory, as the former is more common and the life-blood for many small enterprises.

additional action, provide adequate notice to other secured creditors. *Before* the proceeds arise (excluding 'where the proceeds take the form of receivables, negotiable instruments, rights to payment of funds credited to a bank account, or rights to receive the proceeds under an independent undertaking'), the acquisition secured creditor must inform other secured creditors (in case of the UNCITRAL Guide) or *only* a secured creditor which has registered a notice in the Registry (in case of the Model Law) that the acquisition secured creditor has registered a notice concerning assets of the same kind as the proceeds, in which a secured creditor already has a registered security right.[531] Further, the notice filing and notification to other secured creditors must take place *before* the proceeds arise.[532] In this regard, it would seem practical that the initial notice filed in relation to the encumbered asset should include reference to the proceeds arising from this asset.

Although though the Guide extends super-priority to some proceeds of inventory, the super-priority does not apply to proceeds in the form of receivables,[533] negotiable instruments, rights to payment of funds credited to a bank account, or rights to receive the proceeds under an independent undertaking.[534] The acquisition security right for this type of proceeds enjoys the same priority as a non-acquisition security right. Accordingly, the list of proceeds capable of attracting super-priority is very limited – in fact, it is arguably limited to cash proceeds.[535]

Under alternative B to recommendation 185 to the UNCITRAL Guide and option B to article 41 of the Model Law, the acquisition security right in the proceeds from *any* asset (so including inventory) used as security for acquisition finance, will attract the same priority as a non-acquisition security right.

The practical relevance of this distinction can be questioned. In the majority of acquisition finance transactions, the proceeds *are* 'in the form of receivables, negotiable instruments, rights to payment of funds credited to a bank account, or rights to receive proceeds under an independent undertaking'. Accordingly, it does seem practical to adopt alternative/option B.

(b) Non-unitary approach: restricted to the Guide

531 Alternative A to recommendation 185(*b*) of the UNCITRAL Guide.
532 Alternative A to recommendation 185(*b*) of the UNCITRAL Guide.
533 Which are book debts often used as security in asset-based lending.
534 Option A to recommendation 185(*b*) of the UNCITRAL Guide.
535 The parties may also include other creative and non-traditional methods of payment (eg, shares).

Under recommendation 197, the seller and lessor in the case of a retention-of-title and a financial lease should have a *security right* in the proceeds of the encumbered asset. Recommendation 199 refers to a *security right* in proceeds, while recommendation 185 (discussed *supra*) refers to an *acquisition security right* in proceeds. However, in the context of the Guide, the retention-of-title right or a financial lease right is not regarded as a security right. Recommendation 199 raises two issues: (1) how the rights in proceeds can be regarded as a security right when the right in the original encumbered asset under a retention-of-title or a financial lease does not qualify as a security right; and (2) whether the right under the unitary approach enjoys super-priority whereas the right under the non-unitary does not, as the priority is only 'against another *security right* in the same asset' (emphasis added)? This means that a retention-of-title right or financial lease right in proceeds does not enjoy priority over another *acquisition* security right.

Recommendation 199 also contains alternatives which allow for different approaches to proceeds arising from inventory. In terms of alternative A to recommendation 199, the priority of the retention-of-title right and financial lease right, extends to the proceeds even where the asset is inventory, unless the 'proceeds take the form of receivables, negotiable instruments, rights to payment of funds credited to a bank account, and rights to receive the proceeds under an independent undertaking'. However, to enjoy this priority, the seller or lessor must notify other secured creditors who hold a registered *security right* in assets of the same kind, before the proceeds arise.

Alternative B to recommendation 199 does not distinguish between different types of proceeds. As long as the retention-of-title right, the financial lease right, and the security right in the proceeds are effective against third parties, the security right in the proceeds will have the same priority as a non-acquisition security right.

3.3.4.9 Enforcement

Retention-of-title (in respect of a seller) and financial leases (in respect of a lessor) involve the reservation of ownership. However, where the Guide's functional approach is followed, the creation, third-party effectiveness, and priority of these rights should be treated the same as an acquisition security right. But, historically, the enforcement measures available to the holder of the right of ownership differ from those available of the holder of a security right. This is because the holder of the right of ownership had *ownership* as security. Where a functional

approach is envisaged while retaining the distinct labels of retention-of-title and financial leases, one must ask whether a uniform enforcement framework is even possible under the Guide's non-unitary approach.

(a) Unitary approach

The recommendations dealing with acquisition finance have no detailed provisions on enforcement. Under the unitary approach, a very concise recommendation 186 merely states that during insolvency proceedings, the provisions applicable to other security rights, apply equally to acquisition security rights. There is no mention of pre-insolvency proceedings, but as an acquisition security right is also a security right, the pre-insolvency proceedings applicable to security rights also apply to acquisition security rights. The priority ranking of acquisition security rights is the only significant aspect that would influence insolvency proceedings.

(b) Non-unitary approach: restricted to the Guide

An acquisition security right is also a security right and, therefore, the Guide's enforcement proceedings applicable to security rights, apply equally to acquisition security rights, unless specifically otherwise stated. As a result of the application of the functional approach, the enforcement rules which apply to security rights also apply to acquisition security rights, and arguably also to the rights under a retention-of-title and a financial lease. However, applying the same enforcement rules to a retention-of-title and a financial lease will disturb the consistency of the legal framework as regards sale and lease.[536] The solution appears to be a balancing act. This balancing act requires that the post-enforcement framework for the rights under a retention-of-title and a financial lease, must be brought closer to those for acquisition security rights, but without disturbing the coherence of the sale and lease framework (an almost impossible feat). Therefore, in an attempt to treat acquisition credit providers equally, even though a seller and lessor have the same remedies as an owner, the Guide includes the following aspects that must be added in enforcement rules governing a retention-of-title right and a financial lease right: (1) how the seller or lessor is permitted to obtain possession; (2) whether

536 Recommendation 200(*b*) of the UNCITRAL Guide includes this proviso that the enforcement rules may be adapted provided that the coherence between sale and lease is not disturbed. Even though insolvency is not included, this may equally be the case.

the seller or lessor is required to dispose of the asset and if so, how; (3) whether the seller or lessor may keep any surplus resulting from disposition of the asset; and (4) whether the seller or lessor can claim any amount still owing after disposition, from the buyer or lessee.[537]

Recommendation 202 addresses the retention-of-title right and the financial lease right in insolvency proceedings. In terms of alternative A to recommendation 202, the enforcement provisions which apply to security rights should equally apply to the rights under a retention-of-title and a financial lease. This alternative can be evaluated against alternative B to recommendation 202. Alternative A may be difficult to implement in that it goes against the nature of a security device which uses 'ownership' as security, and because the holder of a right of ownership generally has additional enforcement remedies not available to the holder of other security rights. At the end of the day, the adopting country must make a policy choice as to whether creditors will be satisfied to swap the right of ownership for a lesser right which is similar to an acquisition security right.

Alternative B to recommendation 202 – the non-unitary approach – is the only recommendation which refers to the application of ownership rights in the case of retention-of-title and financial lease. Under alternative B, the laws of the enacting state governing 'ownership', must also apply to rights arising from retention-of-title and financial lease.

Consequently, where a country decides to treat retentions-of-title and financial leases as title-based devices (non-unitary approach), the seller and lessor will need to have the same remedies as an *owner* and not only those of a secured creditor, if non-unitary approach is to function effectively.[538] The only solution is for the enforcement rights available to security rights to be aligned with the enforcement rights of an owner.

3.3.4.10 Concluding remarks: acquisition financing devices

The unitary and non-unitary approaches to acquisition financing are indeed a 'new frontier'.[539] However, this may prove to be an elaborate attempt at a politically-motivated compromise to accommodate different policy choices regarding acquisition financing. The reality may be that it would not be possible to adopt the non-unitary approach. However, the approach of the Cape

537 Recommendation 200(*a*) of the UNCITRAL Guide.
538 SV Bazinas 'Acquisition financing under the UNCITRAL Legislative Guide on Secured Transactions' (2011) 16 *Unif L Rev* 483 at 498.
539 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 232 where the author refers to this dual approach as a 'new frontier'.

Town Convention offers an alternative. Holders of title-based security devices or PMSI holders are not accorded super-priority.[540] Priority is determined using the first-to-file rule. This approach potentially makes it possible to combine all acquisition finance devices in a single framework without having to re-characterise any of these rights as a security interest. The approach under the Cape Town Convention places all creditors on an equal footing and no acquisition financier will enjoy super-priority.

The UNCITRAL framework makes different drafting suggestions, which are influenced by the type of encumbered asset. Where the encumbered asset is inventory, the approach appears somewhat cautious – and all the more so where the encumbered asset is inventory and the associated proceeds are in the form of receivables.

Ultimately, the question is how differently the frameworks for traditional security rights and *quasi*-security rights operate. The extent and efficacy of this disparity is what must inform whether or not reform is necessary. Some of the differences between the frameworks include: (1) generally, *quasi*-security rights need not be registered to achieve third-party effectiveness – for security rights registration is the preferred path to perfection; (2) in respect of enforcement, the seller may repossess and sell the asset and keep any surplus resulting from the sale (this considering the prohibition against *pactum commissorium*); (3) also in respect of enforcement, ownership will still form part of the estate of the seller where the buyer becomes insolvent (unless there is specific statutory intervention in this regard);[541] (4) the seller will not be able to follow the property which forms part of a mass or a product, as the property originally owned no longer exists; and (5) where a reservation of ownership becomes complex, there is always the risk of the transaction amounting to a fraudulent, simulated transaction which will have no legal effect.[542]

3.4 International initiatives: The World Bank

3.4.1 Introduction and background

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540 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 237.

541 As was the case with s 84 of the South African Insolvency Act which created a statutory hypothec in favour of the seller which effectively trades her ownership right for a limited real right in the asset when the buyer becomes insolvent.

542 For example, in terms of English law an extended version of a retention-of-title clause amounts to a charge. Where this charge has not been registered, it will have no effect against third parties. See S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 34.

There appears to be a clear link between economic growth and legal efficiency, especially when dealing with secured transactions law.[543] An organisation like the World Bank, with the goal of economic and/or income growth as a means to alleviate poverty, is also willing to provide technical assistance and legal advice on specific aspects related to secured transactions law. At the very least, the World Bank encourages countries to incorporate the provisions of international legal instruments prepared by international organisations,[544] especially those dealing with secured transactions law.

A traditional legal comparatist may question the value of World Bank publications in law reform. However, the role of and sources of comparative legal studies have changed over the past decades, with publications from institutions like the World Bank not only successfully initiating legal reform,[545] but also sparking debate on 'the economics of comparative law'.[546] It is true that certain publications, as discussed *infra*, might inspire legal reform, but the technical advice and guidance provided by the World Bank could ultimately *lead* to the implementation of legal reform. The flip-side of the argument, though, is that the World Bank's advice may also amount to a subtle form of coercion to adopt a specific framework if the country involved hopes to secure financing.[547] The debate on the true reason behind legal reform resulting from World Bank publications is not taken further in this study. Instead, the aim of this paragraph is to examine the key provisions which form part of an effective secured transactions law framework according to specific World Bank publications.

This aim links to the methodological foundation of the interrelationship between legal and economic efficacy, as well as the discussion on the interrelationship between key policy objectives and fundamental principles to establish an effective secured transactions law framework, also considered in Chapter 1. Three World Bank publications require further mention: the World Bank's *Principles for Effective Insolvency and Creditor/Debtor Rights*

543 See Chapter 1 paragraph 1.2 *supra* for a discussion of the relationship between legal efficiency and economic efficiency.

544 JAE Faria 'Future directions of legal harmonisation and law reform: stormy seas or prosperous voyage' (2009) 14 *Unif L Rev* 5 at 30.

545 R Michaels 'Comparative law by numbers? Legal origins thesis. *Doing Business* Reports, and the silence of the traditional comparative law' (2009) 57 *AJCL* 765 at 765.

546 R Michaels 'Comparative law by numbers? Legal origins thesis. *Doing Business* Reports, and the silence of the traditional comparative law' (2009) 57 *AJCL* 765 at 765 and the discussion of the 'legal origins theory' and also the inclusion of this topic in comparative law books. See, eg, A Nicita & S Benedettini 'Towards the economics of comparative law: the *Doing Business* debate' in PG Monateri (ed) *Methods of Comparative Law* (2012) at 291-305.

547 G McCormack 'American private law writ large? The UNCITRAL Secured Transactions Guide' (2011) 60 (3) *Int'l & Comp LQ* 597 at 602.

(*World Bank Principles*);[548] the *Doing Business Reports*, and specific to this study, the diagnostic tools that form part of these reports; and the 2010 *Secured Transactions Systems and Collateral Registries*, released by the International Finance Corporation (IFC), which forms part of the World Bank Group.[549] The provisions under these instruments need not necessarily be classified either as fundamental principles or as key policy objectives. Realistically, the World Bank documents must be practical to serve their purpose, and therefore, they do not contain comprehensive legal text – unlike legislative guides or law modules.

3.4.2 World Bank's Principles for Effective Insolvency and Creditor/Debtor Rights

The World Bank Principles were developed and initially released in 2001.[550] They were revised in 2008 and again in 2015.[551] It is possible to apply the World Bank Principles to a legal system irrespective of the legal tradition of the country.[552] The principles provide a benchmark against which to evaluate the effective performance of domestic insolvency laws and creditor/debtor rights. The World Bank Principles were developed on the basis of international best practice as regards insolvency systems and debtor/creditor regimes.[553] Indeed, the most recent principles closely resemble the key policy objectives and fundamental principles of the UNCITRAL Guide and UNCITRAL Model Law.

The World Bank Principles are divided into four general parts.[554] Part A consists of eight parts dealing with creditor/debtor rights. Only some of these parts apply specifically to movable property. Part A1[555] sets out the key elements of the principles. Part A2 relates to security in immovable (real) property,[556] while Part A3 deals with security in movable property. Two parts deal with registration: Part A4 which sets out the requirements for a registry system for

548 World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* (2016). See the discussion in paragraph 3.5.2.1 *infra*.

549 *Secured Transactions Systems and Collateral Registries* available at http://documents.worldbank.org/curated/en/517431468344950619/pdf/94182-REVISED-PUBLIC-SecuredTransactionsGuideJan.pdf (date of access: 27 July 2018). This study does not include a detailed discussion of the third document.

550 World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* (2016) at 1.

551 The change from the 2005 to the 2016 version of the World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* shows a commitment to updating the principles in line with developments in the field.

552 World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* (2016) at ii.

553 World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* (2016) at 3.

554 Part B: Risk management and corporate workout; Part C: Legal framework for insolvency; and Part D: Implementation: Institutional & Regulatory Frameworks.

555 This part deals with creditor rights in general (movable and immovable property) so a detailed discussion of this general provision is also excluded from this study.

556 This part is not discussed further in this study.

immovable assets; and Part A5 deals with the registry for security rights in movable assets. Further, three parts deal with enforcement: Part A6 – enforcement of unsecured debt; PartA7 – enforcement of security rights over immovable property; and Part A8 – enforcement of security rights in movable assets. Accordingly, Parts A3, A5 and A8 deal directly with security rights in movable property.

The primary features of a secured transactions *framework* for movable assets are included under Part A3. First, there must be well-defined rules on the creation, enforceability, and third-party effectiveness of security rights.[557] Clear rules relating to consensual security rights (rights created by security agreements) and those arising from operation of law,[558] should also be put in place. Further, it must be possible to take security rights in *all* types of movable asset.[559] Security rights must relate to *any* obligation of a debtor to a creditor, encompassing current and future obligations and including any type of person.[560] Moreover, there must be publicity of security rights through a public notice (generally registration) to creditors and purchasers but also the general public, and publicity must take place at a low cost.[561] Also, there must be clear and predictable priority rules. The acquisition finance rules must be developed either on the basis of general rules that apply to security rights, or by taking cognisance of the ownership rights of sellers in the case of reservation-of-title, or lessors in the case of financial leases.[562]

The 2016 version of the World Bank Principles includes detailed principles relating to the registry for security rights in movable assets (Part A5) and the enforcement of security rights in movable assets (Part A8). The nine principles governing the registry include the following: (1) the notice must be provided in an 'efficient, transparent and inexpensive' way, where 'easily accessible and inexpensive' registration is recommended as the primary publicity method; (2) it should be possible to register a notice before the security right is created;[563] (3) registration takes place when the required information has been included on the prescribed form; (4) the information that forms part of the different notices must be combined so that a

557 The 2005 version only referred to clear rules and procedures on how to 'to create, recognize, and enforce security interests', where the newer version refers to third-party effectiveness, similar to terminology of the UNCITRAL Guide.

558 The 2005 version did not distinguish between consensual security rights and those arising by operation of law. The amendment may be due to the impetus in contractually created security rights.

559 This principle also appeared in the 2005 version.

560 This principle also appeared in the 2005 version.

561 This principle also appeared in the 2005 version.

562 Specific mention of acquisition finance is found only in the updated version and reflects a renewed understanding of the importance of acquisition finance to economic growth. The terminology corresponds to that in the UNCITRAL Guide.

563 This corresponds to the clear distinction in the UNCITRAL Guide and Model law between creation and third-party effectiveness of a security right.

search can take place relying on the grantor's name and if possible the serial number of an asset; (5) it is preferred that the registry should be centralised and electronic; principles (6), (7) and (8) in relation to special registries, recommend coordination with the general registry, while special registries will be beneficial in case of high-value assets (principle 6), securities (principle 7) and intellectual property (principle 8) or securities and rights over securities; and (9) there should be coordination between the general registry and the specialised registries mentioned *supra*.

As regards the enforcement of security rights in movable property, certain principles are suggested. Firstly, both judicial and extrajudicial enforcement methods should be available if this makes enforcement more 'efficient, cost-effective, transparent and reliable'.[564] Further, it must be possible for the secured creditor to propose the acquisition of the asset for partial or total satisfaction of the secured debt.[565] The realisation should also take place in 'good faith and a commercially reasonable manner'.[566] Finally, priority ranking should be determined on the basis of the principles of substantive law. It is evident that many of these principles correspond to the fundamental principles discussed in the UNCITRAL instruments *supra*.

3.4.3 *Doing Business* reports and the legal rights index

Since 2004, the IFC[567] has released reports on the ease of doing business, which are either country or region-specific. These reports are referred to as the *Doing Business* reports. The ten indicators which measure the regulatory environment applicable to a business include: starting a business; employing workers; receiving credit; closing a business; enforcing contracts; protecting investors; registering property; paying taxes; acquiring construction permits; and trading across borders.[568] The 'getting credit index' is relevant to this study, and is discussed further *infra*.

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564 Again, this corresponds to the approach of the UNCITRAL Guide and Model to promote judicial and extrajudicial enforcement. This principle was included in the 2005 version, but the 2016 version has been simplified.

565 The principle was not included in the 2005 version and is again similar to the proposals under the UNCITRAL Guide and Model Law.

566 This is also the standard of conduct for enforcement under the UNCITRAL Guide. However, under the UNCITRAL Model Law, these standards apply to all aspects: creation, third-party effectiveness, and enforcement.

567 One member of the World Bank Group – see Chapter 1 n 13 *supra* for the members of the World Bank Group.

568 A Nicita & S Benedettini 'Towards the economics of comparative law: the *Doing Business Debate*' in PG Monateri (ed) *Methods of Comparative Law* (2012) at 293-294.

Even though the target audience for these reports is investors, policymakers are also influenced by the reports,[569] particularly on what makes an economy more attractive to investors. An investor will be keen to invest in a country with an effective legal framework for insolvency and creditor rights. Thus, policymakers need to include specific key objectives as part of the secured transactions law framework to make a country more attractive to investors. This study does not attempt an analysis of the approach of the *Doing Business* reports,[570] but only mentions those diagnostic tools specifically related to insolvency and creditors rights. The study will not add to the 'legal origins thesis' debate, which indirectly contributed to the development of the *Doing Business* reports.[571]

The World Bank has developed diagnostic tools that can also be used to measure aspects of the efficacy of a country's secured transactions framework. These tools are the Indicator on Getting Credit of the *Doing Business* report, with particular reference to the Legal Rights Index and the *Insolvency and Creditors Rights Report on Observance of Standards and Codes*.[572] The former is discussed in greater detail.

The purpose of the Legal Rights Index is to determine whether the laws governing taking collateral and bankruptcy can facilitate *effective* lending.[573] The Legal Rights Index consists of a twelve-item scorecard,[574] and a country is awarded a score out of twelve. The higher the

569 R Michaels 'Comparative law by numbers? Legal origins thesis. *Doing Business* reports, and the silence of the traditional comparative law' (2009) 57 *AJCL* 765 at 772.

570 Criticism from especially civil-law countries such as France and Germany to a lesser extent, resulted in a review culminating in a revised methodology. See R Michaels 'Comparative law by numbers? Legal origins thesis. *Doing Business* reports, and the silence of the traditional comparative law' (2009) 57 *AJCL* 765 at 775.

571 The gist of the 'law matters' thesis, is that legal institutions influence economic growth. See G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 61. A controversial and perhaps an over-generalisation, is that common-law countries on average perform economically better than civil-law countries. In this regard see R Michaels 'Comparative law by numbers? Legal origins thesis. *Doing Business* reports, and the silence of the traditional comparative law' (2009) 57 *AJCL* 765 at 765-795 on the general nature of this thesis and the relevance of the *Doing Business* reports. See also, the discussion in G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 61-62.

572 According to R Michaels 'Comparative law by numbers? Legal origins thesis. *Doing Business* reports, and the silence of the traditional comparative law' (2009) 57 *AJCL* 765 at 766, the *Doing Business* reports are one of the most important developments in comparative law 'you have not heard of' and these reports have been successful in igniting legal reform in many countries.

573 World Bank 'Secured transactions systems and collateral registries' 2010 at 19 available at http://documents.worldbank.org/curated/en/517431468344950619/pdf/94182-REVISED-PUBLIC-SecuredTransactionsGuideJan.pdf (date of access: 28 June 2018).

574 Previously a ten-point scorecard, but the *Doing Business 2018* reports expanded to twelve items (see, eg, the SADC report at http://www.doingbusiness.org/reports/~/media/WBG/DoingBusiness/Documents/Profiles/Regional/DB2018/SADC.pdf (date of access: 3 July 2018). The items are listed at http://www.doingbusiness.org/Methodology/Getting-Credit. Item 1 above, was included as a new item and the previous requirement for the collateral registry was expanded into three detailed requirements listed as items 6-8.

score, the better equipped the collateral and bankruptcy law will be to increase access to credit.[575] In the World Bank *Doing Business 2019* report, South Africa scored 5 out of 12 on the Legal Rights Index.[576] This score does not compare well to other African countries, for example, Rwanda, Zambia, and Malawi (all with improved PPSA statutes)[577] scored 11.[578] An unreformed secured transactions law regime is 'expensive, burdensome and inefficient',[579] which is something a developing country like South Africa simply cannot afford. The elements in this index include the following features of a country's laws.[580]

1) Whether the country has an 'integrated and unified legal framework for secured transactions'.[581] This cuts across all aspects – creation, publicity, and enforcement of a security right – of the secured transactions law framework. It also involves whether the framework includes the functional equivalents of a security right, which include financial leases, assignment or transfer of receivables, and retention-of-title.[582]

2) Whether the law allows businesses to grant a non-possessory security right in an economic unit of movable assets (eg, machinery or inventory) without the need for a specific description of the collateral.[583] This element points to the importance of the specificity principle as part of the secured transactions law framework.

3) Whether the law allows commerce to grant a non-possessory security right in all of its assets without necessitating a specific description of the collateral (an 'all-asset' security). Again, this goes to the importance of the specificity principle as part of the secured transactions law framework.

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575 See M Mourahib & O Lemseffer 'Reforming an established secured transactions legal system: Why and how Morocco is approaching the challenge' in F Dahan (ed) *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 401-402. The authors used the previous version of this index to compare the impact of reform on the improvement of the strength of the security.

576 World Bank Group *Doing Business 2019*: *Training for Reform* (*Doing Business 2019*) at 203 available at http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf (date of access: 31 May 2019).

577 M Dubovec & C Kambili 'Using the UNCITRAL Legislative Guide as a tool for secured transactions reform in sub-Saharan Africa: the case of Malawi' (2013) 30 *Ariz J Int'l & Comp L* 163 at 163-185 where the reform in Malawi aimed at a PPSA statute is discussed.

578 *Doing Business 2019* at 186, 199, 215.

579 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 176.

580 See *Doing Business 2019* at 96 where the items on the score card were confirmed for the 2019 reporting period.

581 Under the UNCITRAL Guide and Model Law, the corresponding key objective relates to a 'functional, integrated and coordinated framework'.

582 The 'unitary concept' is not specifically mentioned.

583 The index subsequently moves away from the specificity requirements towards a more generic approach, similar to the approach under the UNCITRAL Guide.

4) Whether the security right may include future or 'after-acquired' assets (the latter term is used in the OAS Model Law), and further, whether the security right automatically extends to the products, proceeds, or replacements of the original asset. The aspect of the replacement of the original asset links to whether the security right continues into the mass or product.

5) Whether the law allows for 'a general description of debts and obligations permitted in collateral agreements'; whether all types of debt and obligation between parties can be secured; and whether the collateral agreement must include a maximum amount for which the assets are encumbered.

6) Whether the country has a properly functioning collateral registry or a registration institution for security right over the movable property for individuals and entities, which is geographically unified, has an *electronic* database indexed according to debtors' names.[584] The index would, therefore, appear to prefer a debtor-based registry over an asset-based registry. Likewise, an electronic registry is seen as preferable to a paper-based registry.

7) Whether the collateral registry is a *notice*-based registry and publishes the rights under the functional equivalents of security rights.[585] The index, therefore, favours notice-filing over transaction-filing.

8) Whether the collateral registry is a modern system which allows a secured creditor or its representative to register, search, amend, or cancel the security interest online. Thus, the system must be fully computerised and accessible worldwide.

9) Whether, outside of an insolvency procedure, secured creditors are paid first (that is, before tax claims and employee claims) when a debtor defaults.

10) Whether certain secured creditors are paid first (that is, before tax claims and employee claims) upon liquidation of the business.[586]

11) Whether secured creditors are 'either not subject to an automatic stay on enforcement' as soon as debtor go into a court-supervised reorganisation procedure, or whether the legal framework gives secured creditors grounds for reprieve from an automatic stay and/or sets a time limit to it.

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584 The debtor-based registry is also prescribed in the UNCITRAL Guide.
585 This presupposes an inclusion of title-based devices where publicity of these rights takes place.
586 This item and item (9) relate to bankruptcy law specifically and the remaining 8 relate to collateral law.

12) Whether the legal systems permits the parties to agree in the collateral agreement (the security agreement) to extrajudicial enforcement, whether it allows for public and private auctions, and whether the law allows a creditor to take the property to satisfy the debt (*quasi*-conditional sale). The index essentially favours extrajudicial enforcement. Further, the right to take over the asset to satisfy the outstanding debt should form part of a secured transactions law framework. The index, however, lacks detail regarding the standard applicable in establishing the value of the collateral.

3.5 Conclusion

It is undeniable that the efforts of international organisations – UNCITRAL, for example – continue to influence national secured transactions law reform. The soft-law instruments, which include the UNCITRAL Guide and Model Law and the World Bank instruments, influence general reform of secured transactions law. Conversely, industry-specific reform arguably takes place through hard-law instruments – the Cape Town Convention and its Protocols, for example. From the discussion of the UNCITRAL instruments, it emerged clearly that the key policy objectives provide a general policy framework for reform, while the fundamental principles (policies) fill in the gaps, so to speak, by providing the detailed provisions which make it possible to implement practical provisions which will meet the key policy objectives.[587] Accordingly, implementing the key policy objectives and fundamental principles recommended in the UNCITRAL instruments discussed in this chapter, will improve the legal efficiency of the legal framework for security rights in movable property. However. whether the fundamental principles in the UNCITRAL instruments will contribute to the legal efficacy of a framework, ultimately depends on how the research questions, posed in Chapter 1 of this thesis, are answered. Accordingly, the chapter conclusion exemplifies the association between the fundamental principles and the research questions.

3.5.1 Should a unitary or non-unitary approach to a secured transactions law framework be adopted?

[587] Paragraph 3.5 *supra* illustrated which fundamental principles have achieved a specific key objective. Chapter 5 paragraph 5.2.1 *infra* illustrates that these key policy objectives comply with the requirements of legal efficiency.

The difference between a unitary and non-unitary approach, in essence, is whether the legal jurisdiction in question has implemented a formal or a functional approach to its secured transactions law framework.[588] The formal approach coincides with a clear distinction between traditional security rights and *quasi*-security rights, including separate legal frameworks for each category. In turn, under the functional approach, the distinction between traditional security rights and *quasi*-security rights is for the most part disregarded.[589] Almost always, the functional approach will be implemented using a unitary concept of a security right (or interest) to classify all types of right in assets used to secure the performance of an obligation under the security agreement. However, it is possible to follow a functional approach without introducing the unitary concept of a security right – which amounts to treating security devices as functional equivalents. This entails maintaining the separate characterisation of security devices, while essentially applying a unitary framework in respect of all types of security device. An example of a framework which uses a uniform system is the OAS Model Law, discussed in Chapter 4.

The UNCITRAL instruments support a unitary approach. But the Guide has created an elaborate compromise to include the distinct labels attached to title-based transactions as part of the non-unitary approach to acquisition finance. From the discussion of acquisition security rights *supra*,[590] it is clear that this solution is superficial and merely complicates an already intricate system. The Model Law follows the unitary approach, which arguably is a workable alternative if all title-based devices must be housed under a single framework.

A right under a retention-of-title or financial lease remains a *quasi*-security right in the non-unitary approach. However, the idea behind a non-unitary approach is to apply the same (or similar) rules in respect of creation, third-party effect, priority, and enforcement to both acquisition security rights and the *quasi*-security rights (the retention-of-title right and the financial lease right). Accordingly, the substance for the two different regimes must be determined to allow the two sets of rules to move closer to each other and function under a unified framework as far as possible. The concluding remarks to the discussion on acquisition financing included examples of how the frameworks for traditional security rights differ from those for *quasi*-security rights where ownership is used to secured the performance of a contractual obligation.[591] These differences also apply to the distinction between a security

588 S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 24, 32.
589 S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 32.
590 See paragraph 3.3.4 *supra*.
591 See paragraph 3.3.4.10 *supra*.

right under the UNCITRAL instruments and *quasi*-security rights (retention-of-title right and a financial lease right). As regards creation, both a security right and *quasi*-security right are created by an agreement. However, a *quasi*-security right becomes effective against a third party when the agreement is concluded, whereas the security right requires an additional action (registration, possession, or control). Moreover, as regards priority, in most respects the practical outcome of being an owner as opposed to holding super-priority, is the same in most instances. However, an acquisition secured creditor needs to take further steps to qualify for the super-priority (registration and a notice requirement), whereas the reservation of ownership merely requires the conclusion of a contract.[592] There are marked differences in respect of the enforcement measures applicable to *quasi*-security rights and security rights respectively. These include: the seller being able to keep any surplus remaining after disposing of the collateral; the seller not being able to follow the property when it becomes part of a mass or a product (which differs from the right under the UNCITRAL instruments); and the risk that the form of the secured transaction will not be acknowledged under the legal framework (conversely, the UNCITRAL framework applies a 'substance-over-form' approach).

Incorporating this alternative in a non-unitary approach to acquisition finance was an acceptable compromise. However, it does not, in practical terms, resolve the issue of title-based security devices. The preliminary recommendation of this thesis is that the adopting country must choose to either fully adopt a unitary approach in the form of a security right, or retain the separate labels for security devices while accepting that the nature of a title-based device makes it impossible to apply a completely uniform secured transactions law framework which will accommodate the nuances inherent in using ownership as security.[593]

3.5.2 Should the method of creating a security right be revised?

The idea of having a contractually-created property right is challenging when viewed against traditional property law principles and concepts. It is a strange prospect to allow for the creation of a property right that is enforceable only *inter partes* since the traditional notion is that a security right should be a property right enforceable against third parties. If the supposed 'property' right only applies *inter partes*, it is hard to conceive it as anything more than a personal obligation between the parties. A framework which allows multiple security rights to

592 See paragraph 3.3.4.7 *supra* for these additional measures that must be taken.
593 It is a separate legal question whether there should be equal treatment of all types of creditor operating in a single framework. The discussion in this paragraph also answers this research question.

be created in the same asset, is of little value where it cannot be enforced against other secured creditors with a security right in the same asset. Also, the conundrum remains that a debtor grants security rights in favour of multiple secured creditors potentially without those secured creditors being aware of each other (a lack of transparency). This lack of transparency not only exposes the creditor to the risk of advancing funds where there may no longer be adequate valued locked in the asset, it also fails to provide information that would persuade the creditor to file a notice timeously in order to secure a higher priority ranking as a result of the filing. Essentially, a contractually created property right which applies *inter partes* will operate successfully where there is only one secured creditor, or the creditor can prevent the debtor from granting multiple security rights in the same asset (probably by using a negative pledge as part of the security agreement).

3.5.3 How comprehensive (or inclusive) should the scope of the secured transactions law framework be?

Essentially, it should be possible to use any type of asset that has an economic value as security to ensure the debtor's performance of most types of obligation originating from any type of secured transaction. Whether a specific type of asset falls outside the scope of the framework should depend on whether its inclusion either: (1) serves no economic benefit; or (2) including this type of asset will result in over-complicating the framework (eg, intermediated securities or the rights under netting agreements). This is the recommended approach under the UNCITRAL instruments where the scope of the types of asset that may form part of the framework is wide, but reference is made to specific types of asset that should be excluded for sound practical reasons.

The UNCITRAL instruments do not extend the acquisition security right to proceeds in the form of receivables. This balances the rights of the acquisition financier and the financier of receivables to some extent. The effect is that the acquisition financier is in a weaker position as it will not be able to follow the goods into the hands of a third party when the goods are sold. The reason for this is the application of the exception for goods sold in the ordinary course of business. Therefore, the acquisition financier does not have a preferential claim to the proceeds from the goods where the goods are sold on credit, as the super-priority only extends to cash proceeds. Even if the goods are sold for cash, the acquisition security right only extends to identifiable cash proceeds. Cash is paid into a central bank account and is mixed with other

funds. The UNCITRAL instruments resolve the issue of the commingling of funds by removing the requirement that proceeds of *this* type must be 'identifiable' for the super-priority to continue to exist.

The functional approach of the UNCITRAL instruments also avoids a fragmented approach where specific types of security device are available to take security in certain types of asset (eg, special notarial bonds under the SMPA which cannot be registered in respect of incorporeal movable property).[594] Further, the arguably archaic principles of not extending the security right in a movable property to a mass, a product, or an immovable asset, where an encumbered asset is attached to this immovable property (an attachment), must be revised to reflect a modern and commercially relevant approach. The UNCITRAL Model Law does not recommend that a security right be extended to an attachment. Conversely, the approach of the Guide, which does allow extension to an attachment, is preferred, and it is suggested that the domestic laws on accession should reflect this approach. This extension makes commercial sense and it seems unreasonable to allow the immovable property owner to benefit where there is a workable alternative. Moreover, it also makes commercial sense to allow a security right to continue in a mass or product, subject to a monetary restriction (in case of a product) or quantity restriction (in case of a mass). This corresponds to the recommendation under the UNCITRAL Model Law and the UNCITRAL Guide (even though the Guide includes a monetary restriction only). However, this constitutes an exception to the traditional property-law rules. The mass or a product is a new asset, and the elements used to form this mass or product no longer exist as separate entities. The mass or product is also not 'proceeds' as the original element (asset) is no longer identifiable. Therefore, the security right – which is a right in a specific property – continues in the newly transformed property. However, the priority ranking of the security right in the pre-commingled or pre-transformed asset survives and is 'allocated' in respect of the security right in the newly transformed product. If this theory is supported, the question is whether the security right can survive on its own where the original encumbered asset no longer exists.

Indeed, the UNCITRAL instruments both recommend that the security right should exist in respect of a future asset. This does not contravene the accessory principle as the right will only exist once the debtor acquires a right to encumber the collateral. Nevertheless, the compromise is that even though the security right will only become effective against third

[594] See Chapter 2 paragraph 2.5.4.1 *supra*.

parties once it has been properly created, the priority ranking is determined with reference to an earlier registration (ie, notice-filing took place before the security right existed).

3.5.4 What is the best method for achieving third-party effectiveness?

All the instruments discussed in this chapter recommend notice filing as the general method for third-party effectiveness. However, possession and control are valid alternatives provided they are subject to the security being a specific type of asset. Only the UNCITRAL Guide considers registration in specialised registries or notation on a title certificate as valid alternative methods by which to establish third-party effectiveness. It is understandable that the Guide includes this option. However, the practical result is that a secured creditor will need to consult multiple registers to confirm whether an asset is already encumbered. Also, where these special types of registries remain, it will have the effect of preferring one type of asset – the asset registered in this registry – over an asset registered in the general registry. However, the Model Law correctly only includes a reference to the general registry, thus having a combined registry for all assets. Both the UNCITRAL Guide and the UNCITRAL Model Law specifically exclude assets which will be subject to specialised legal regimes (eg, aircraft). It would appear, then, that those registries will be kept separate. If this is indeed the case, the result will be two parallel systems of security rights operating in the domestic framework. Again, the priority of these distinguishing rights needs to be addressed as part of the reform.

The choice between notice-filing and transaction-filing depends on the objective a country intends to achieve. According to Akseli, notice-filing provides sufficient notice to third parties without compromising the confidentiality of a transaction.[595] Notice-filing also allows for advance notice of future security rights. But, as is clear from the discussion of covering bonds in Chapter 2, it is possible to use transaction-filing for future assets.[596] An advantage of notice-filing under the Guide is that a single notice-filing has the potential to cover multiple transactions, which is particularly advantageous in the case of revolving or future assets. This is also possible in case of covering bonds, a form of transaction-filing in South Africa.

595 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 199.

596 Chapter 2 paragraph 2.2.2.2(*a*) *supra*.

Notice-filing generally operates 'as a warning that a security right may exist',[597] but it is not required for the creation of a security right, for which transaction-filing is usually the constitutive step in the creation of the security right. Accordingly, it is only possible to use notice-filing where the creation of a security right and third-party effect take place at different times. Where notice-filing is chosen, the accessory principle cannot apply if the security right is *created* as a result of the filing of notice. The only solution then is that the notice only serves as a warning to third parties and has no effect on the creation of the security right. However, it is also possible to use transaction-filing, even where there is a clear separation between the creation of the right and third-party effectiveness. The only limitation is that there can be no advance filing under transaction-filing.

3.5.5 What is the legal effect of a security right on third parties?

The Guide attempts to achieve a clear and predictable priority regime. Nevertheless, the host of different levels of priority does make the system more complex. First, it must be determined whether a right has been registered in a specialised registry to outrank all other rights. Then it must be determined whether the secured creditor has complied with all the requirements for super-priority to be accorded the acquisition security right. Especially in the case of inventory, it may need to be established whether the secured creditor complied with the notice requirement. It is also not entirely clear whether third-party effect ceases if the secured creditor loses possession, as is the case with traditional pledges.

Further, where a notice has been filed in respect of future assets, the priority is determined with reference to the date of filing, not the date when the security right arose. However, an entry in a registry is not proof *per se* that the security agreement was concluded after filing. The debtor needs to confirm whether the security agreement, which created the security right, has or has not been concluded.

3.5.6 Efficacy of enforcement mechanisms

It is clear why a secured creditor would wish to avoid the courts and rather opt to use extrajudicial enforcement (which includes extrajudicial dispossession and extrajudicial

597 See E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 247 and the authors reference to HC Sigman 'Some thoughts about registration with respect to security rights in movables' (2010) 15 *Unif L Rev* 507 at 508.

disposition). All of the frameworks considered include the possibility of extrajudicial enforcement. However, the success of extrajudicial enforcement depends on the consent of the debtor and whether other interested parties receive adequate notice.

The stages of enforcement under the UNCITRAL framework correspond to the stages identified under domestic frameworks. Taking possession corresponds to the right to take possession, usually contained in a perfection clause. In terms of the UNCITRAL instruments, possession may take place without court intervention. Conversely, it is not possible in most domestic frameworks (especially those of civil-law jurisdictions) to take possession without an attachment order obtained through a judicial process.[598] Nevertheless, in a domestic framework where the secured creditor has already obtained possession on the basis of an attachment order, *parate executie* may take place without court intervention, but subject to the consent of the debtor.[599] This is similar to the provisions dealing with extrajudicial disposition in the UNCITRAL instruments. The requirements under the UNCITRAL instruments are in fact somewhat cumbersome when compared with some domestic frameworks. The secured creditor must not only obtain consent from the debtor, she must also provide other interested parties with a disposition notice (in addition to the possession notice). However, the more cumbersome process must be seen against the UNCITRAL framework also allowing extrajudicial repossession, whereas a domestic framework would, at the least, require court intervention in respect of the attachment of the movable property.

Unfortunately, none of the instruments discussed above includes the requirement that a fair value must be included as part of the default notice. Knowledge of the value of the encumbered asset is particularly relevant if the secured creditor intends to take over the asset in satisfaction of the debt.

Although ADR can be seen as a 'creative suggestion' made by the UNCITRAL Model Law, this process generally applies to disputes between two parties with no third-party effect. Consequently, where multiple secured creditors are involved, all those creditors are joined to the arbitration proceedings.

3.5.7 Equal treatment of all creditors providing credit to debtors for the acquisition of movable assets

598 See Chapter 2 paragraphs 2.4.5.3 and 2.5.8.1 *supra*.
599 See Chapter 2 paragraph 2.4.5.2(*c*) *supra*.

The concluding remarks on acquisition financing *supra* have already dealt with this aspect and are not repeated here.[600]

As previously indicated, provisions of international instruments inspire the content of regional instruments and *vice versa*. The following chapter deals with the most common regional secured transactions law instruments.

600 See paragraph 3.3.4.10 *supra*.

CHAPTER 4
REGIONAL SECURED TRANSACTIONS LAW FRAMEWORK

4.1 Introduction and background

International and regional reform efforts concerning secured transactions law are viewed as either having competing strategies, or as complimenting each other.[1] Regardless of the exact nature of this interrelationship, regional instruments have influenced the content of the provisions of international instruments.[2] More often than not, domestic law reform takes place in line with regional guidance. The challenges raised by secured transactions law reform are also arguably more easily resolved on a regional level. Fewer parties need to buy into a proposal, and this results in the adoption of concise yet practical key policy objectives and fundamental principles. Consequently, the 'law' in these instruments may offer a workable solution for domestic jurisdictions in the process of secured transactions law reform.[3] Furthermore, the need to compromise on the provisions that must be included to appease everybody is less apparent on a regional level.[4] Likewise, some of the regional instruments originate from development banks, so a country has a direct financial incentive in following a regional instrument in that it is not uncommon for the approval of a loan to be subject to compliance with certain provisions in those regional instruments. The text of these documents is not necessarily as detailed as that in some international (or other regional) legal frameworks – eg, the UNCITRAL Model Law. The flexibility of these legal frameworks leaves room for

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1 See G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 102, where this is expressed as a general perception of UNCITRAL with reference to the opinions of Mistelis and Bazinas. Then, see JAE Faria 'Future directions of legal harmonisation and law reform: stormy seas or prosperous voyage' (2009) 14 *Unif L Rev* 5 at 7, where the author refers to 'the dawn of inter-regionalism'.

2 European Bank for Reconstruction and Development Model Law on Secured Transactions (prepared by the European Bank for Reconstruction and Development) and the Model Inter-American Law on Secured Transactions (prepared by the Organization of American States) were used as a basis for drafting the UNICTRAL Legislative Guide on Secured Transactions (UNCITRAL Guide).

3 For a general discussion of the role of universalism and regionalism in law-making, see J Basedow 'Worldwide harmonisation of private law and regional economic integration-general report' (2003) 8 *Unif L Rev* 31 at 31-49. Also, acccording to RA Macdonald 'A model law on secured transactions. A representation of structure? An object of idealized imitation? A type, template or design? (2010) 15 *Unif L Rev* 419 at 444, it is possible for regional models to operate from the 'lowest-common denominator' perspective (what was agreed to be included in the legal framework).

4 Drobnig refers to regional unifications as 'promising and realistic'. See U Drobnig 'Unified rules on proprietary security–in the world and in Europe' (2009) 85 *Bol Fac Direito U Coimbra* 667 at 669.

the relevant domestic system to adapt in line with the core principles proposed in the regional instruments.

It is both interesting and noteworthy that there are regional initiatives regarding secured transactions law reform in most regions of the world. This is indicative of the universal appetite for reform and modernisation in this field. For example, the Organization of American States (OAS) represents the Americas, while the *Organisation pour l' Harmonisation en Afrique due Droit des Affaires* (Organisation for the Harmonisation of Business Law in Africa) (OHADA) represents certain African countries.[5] Moreover, two regional development banks are responsible for significant regional influence: (1) the Asian Development Bank in the Asian region; and (2) the European Bank for Reconstruction and Development (EBRD),[6] which influences reform in Central and Western Europe and even extends its reach to some countries in the Middle East and North Africa.[7]

This chapter is devoted to regional reform efforts and aims to achieve three objectives. First, it provides a synopsis of the applicable soft-law principles[8] in regional legal instruments on secured transactions law. The discussion identifies and then expands on the key policy objectives (or core principles) and fundamental principles (policies) that form part of those secured transactions law instruments prepared by the EBRD and OAS, as the precursors to the UNCITRAL Guide. Ultimately, the aim is to provide a framework for effective secured transactions law incorporating perspectives from regional initiatives – more specifically using the EBRD and OAS frameworks. Although not all regional efforts are analysed in detail, the following paragraph provides a concise discussion of other regional efforts aimed at secured transactions law reform.

4.1.1 A synopsis of regional efforts aimed at secured transactions law reform

Regional efforts originate either from regional organisations[9] or regional financial institutions.[10] Regional organisations and financial institutions that have developed secured

5 The Southern African Development Community (SADC) has not contributed to reform, despite some of its members, Malawi and Zambia having already adopted modernised secured transactions laws. Another member, Zimbabwe, is in the developmental phase of secured transactions legislation.
6 Hereafter the EBRD.
7 Referred to as the MENA region.
8 The concept of 'soft law' is explained in Chapter 3 paragraph 3.2.2 *supra*.
9 For example, OHADA and the OAS.
10 For example, the Asian Development Bank and the EBRD.

transactions law frameworks represent countries with varying political climates and legal systems.[11]

On the African continent, the efforts have come from the *Organisation pour l' Harmonisation en Afrique due Droit des Affaires* (Organisation for the Harmonisation of Business Law in Africa).[12] Countries from Central and West Africa expressed the need to modernise existing commercial laws as a means of attracting foreign direct investment,[13] but also to adopt new commercial laws suited to the unique African context. The expression culminated in the creation of the OHADA through the signing of the OHADA Treaty in October 1993. Seventeen African states are currently members of the OHADA,[14] with many of these states following a civil-law tradition.[15] The OHADA has promulgated eight uniform commercial Acts, one being the Uniform Act Organizing Securities (UAS), enacted in December 2010.[16] The UAS has a dual nature, being both a model law and a Uniform Act as it applies directly in the member countries.[17] The UAS replaced the previous Uniform Act of April 1997.[18] The UAS does not follow a unitary approach. It distinguishes between separate security devices, for example, pledges (both possessory and non-possessory) and mortgages. However, the Act does follow a functional approach applicable to security devices.[19] Some of the key features of the 2010 amendment of the UAS, include: (1) instituting rules that make it possible to grant security to a security agent held on behalf of a third party (contained in

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11 U Drobnig 'Unified rules on proprietary security–in the world and in Europe' (2009) 85 *Bol Fac Direito U Coimbra* 667 at 669.

12 Hereafter referred to as OHADA following the French version of the name, promulgated the Uniform Act Organising Securities (official French title: *Acte uniforme portant organisation des sûreté*) (1997) available at http://www.ohada.com/actes-uniformes/458/uniform-act-organizing-securities.html (date of use: 11 November 2014). Thereafter, OHADA adopted a new uniform act on security in 2010 but is available on the website only to OHADA members. For a brief discussion of the origin of OHADA see CM Dickerson 'OHADA on the ground: harmonizing business laws in three dimensions' (2010) 25 *Tul Eur & Civ LF* 103 at 103-118.

13 CM Dickerson 'OHADA on the ground: harmonizing business laws in three dimensions' (2010) 25 *Tul Eur & Civ LF* 103 at 105.

14 See https://www.ohada.org/index.php/en/ for a list of current members (date of access: 20 February 2019).

15 Member countries that follow the civil-law tradition include Benin, Burkina Faso, Democratic Republic of the Congo, Gabon, Guinea, Equatorial Guinea, Senegal, and Chad. Some of the other countries have a mixed legal system, where customary law and Islamic law are followed along civil law (these include Comoros and Niger, for example).

16 The UAS entered into force on 15 May 2011 according to the OHADA website. See https://www.ohada.org/index.php/en/organisation-des-suretes-en/auds-presentation-et-innovations-en (date of access: 20 February 2019).

17 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 482.

18 See https://www.ohada.org/index.php/en/organisation-des-suretes-en/auds-presentation-et-innovations-en (date of access: 20 February 2019).

19 For example, including a 'single public registry'. See HL Buxbaum 'Unification of the law governing secured transactions: progress and prospects for reform' (2003) 1 *Unif L Rev* 321 at 333 and the references at n 60.

Chapter 2 of the UAS);[20] it is now possible to secure future debts (provided they are determinable) and take security in future assets;[21] the UAS now permits 'self-help' in respect of the enforcement of a security right in certain types of property;[22] a security interest can be created by a written document in respect of a pledge of receivables; and the UAS recommends a simple system for the filing of security interests.[23] This study will not include a detailed discussion of the UAS as it did not serve as a precursor to the development of the UNCITRAL Guide.

The OAS was formed in 1948. The organisation's five main areas of work focus on: 'democracy; human rights; security; economic development; and the development of international law'.[24] The efforts at secured transactions law reform from the OAS include, but are not limited to, the publication of the Model Inter-American Law on Secured Transactions in 2001,[25] and its accompanying Model Registry Regulations in 2009.[26] The OAS's efforts deserve a separate discussion as a precursor to development of the UNCITRAL Guide.

The Asian Development Bank (ADB) conducted the first comparative study of Asian secured transactions laws,[27] and has assisted countries in the region with secured transactions law reform.[28] The ADB has not to date produced a Model Law or a similar document, but it has developed a guide for movable property registries.

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20 This means that a party can now manage and receive collateral on behalf of a third party.

21 For example, see the reference in arts 92 and 93 of the UAS where the pledge of tangible property exists in future assets and in respect of future debts.

22 See art 104 of the UAS and the reference to an exception concerning enforcement in case of a sum of money.

23 M Gdanski & P Bahamin on behalf of *Norton Rose Fulbright* 'OHADA's Uniform Law on Security Interests' available at https://www.insideafricalaw.com/publications/ohadas-uniform-law-on-security-interests-harmonising-business-law-across-africa (date of access: 6 of June 2019).

24 JM Wilson 'Model Registry Regulations under the Model Inter-American Law on Secured Transactions' (2010) 15 *Unif L Rev* 515 at 516. The last three areas are important for this study.

25 Approved by the 6th Inter-American Specialised Conference on Private Law on 8 February 2002. For a general discussion of the legislative process, see AM Garro 'The OAS-sponsored Model Law on Secured Transactions: gestation and implementation' (2010) 15 *Unif L Rev* 391 at 396-399.

26 Approved by the 7th Inter-American Specialised Conference on Private Law on 9 October 2009. The main objectives of the working committee that drafted the Model Law are included below.

27 Also see the first regional effort at secured transactions law, *Asian Secured Transactions Laws* published in eleven volumes prepared by the Asian Development Bank between 1973 and 1980. See J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at n 18 at 483-484 for the individual titles of the eleven volumes.

28 Examples include Palau, Marshall Islands, Papua New Guinea, Solomon Islands, Tonga, Vanuatu, and Timor-Leste. See a report on reform in Pacific Island economies available at https://www.adb.org/sites/default/files/publication/42904/unlocking-finance-growth-pacific-island-economies.pdf (date of access: 1 August 2018).

The most influential efforts on the European continent originated from the EBRD,[29] discussed separately *infra*, and to some extent from Book IX of the Draft Common Frame of Reference (DCFR).[30] Although the work undertaken by and the potential contribution of the DCFR must not be discounted, the regional adoption and support for this draft uniform commercial code is currently not widespread.[31] The most probable reason for this is the vast differences in the principles of property law in Europe, and significant doubts as to whether the framework will be suitable for specific European traditions and economic and cultural requirements.[32] The chapter in the DCFR dealing with secured transactions shares some similarities with the provisions of UCC Article 9 and the UNCITRAL Guide. The DCFR applies the functional approach,[33] as do the UNCITRAL Guide and UCC Article 9. However, unlike the Guide and UCC Article 9, the DCFR proposes that registration of the security interest should take place in a *regional* European Register of Movable Assets, and not in individual domestic registries.[34]

The remainder of the discussion in this chapter regarding the regional efforts, focuses on the instruments drafted by the EBRD and the OAS.[35] The EBRD Model Law and the OAS Model Law are considered precursors to the UNCITRAL Guide.[36] Both instruments follow a comprehensive approach but differ in many respects when it comes to the implementation of the respective approaches. The OAS Model Law uses the concept of a 'security interest' for all security rights, but does not necessarily follow a unitary approach (rather a uniform system of legal rules). The EBRD Model Law also uses different types of charge instruments in line with

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29 The EBRD published their Model Law on Secured Transactions (1994) available at http://www.ebrd.com/pages/research/publications/guides/model.shtml (date of access: 11 November 2014). Also, see the EBRD Core Principles for Secured Transactions Law (1997) available at https://www.ebrd.com/documents/.../secured-transactions-core-principles-english.pdf (date of access: 1 August 2018).

30 The DCFR was prepared by a group of legal scholars, collectively referred to as the Study Group on a European Civil Code, from forty European Commission member states.

31 HD Gabriel 'Towards universal principles: the use of non-binding principles in international commercial law' (2014) 17 *Int'l Trade & Bus L Rev* 241 at 248, where the author concludes that the DCFR is regarded as 'too unwieldy' probably collecting dust on an academic's bookshelf. This thesis refrains from taking part in the debate on the relevance and suitability of the DCFR.

32 U Drobnig 'Unified rules on proprietary security–in the world and in Europe' (2009) 85 *Bol Fac Direito U Coimbra* 667 at 675.

33 E Dirix 'The new Belgian Act on Security Interests in Movable Property' (2014) 23 *IIR* 171 at 179.

34 AC Perera & K Lyczkowska 'Conflicts among creditors in the regulation of security interests under the Draft Common Frame of Reference: a view from Spanish law' (2011) 6 *Eur Rev Priv Law* 1001 at 1002. The principles in respect of registration also influenced the Belgian reform. See E Dirix 'The new Belgian Act on Security Interests in Movable Property' (2014) 23 *IIR* 171 at 177.

35 The choice of these instruments does not necessarily reflect on the legal standing or importance of these or other regional legal instruments.

36 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 102 and NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 11.

common-law practice, but then incorporates certain civil-law concepts into its text. Both regional instruments take the form of a model law – in other words, soft-law instruments. The remainder of the discussion concerns the general features of each instrument, followed by a discussion of the key objectives and fundamental principles that form the foundation for each instrument.

4.2 The European Bank for Reconstruction and Development

4.2.1 Introduction and general features of the EBRD instruments

The EBRD was established in 1991 to support the establishment of a prosperous economic climate for a post-cold war era in Central and Eastern Europe.[37] To this end, one of the aims of the EBRD is to inspire countries in that region to adopt modern secured transactions law frameworks. It also offers technical assistance to countries intending to adopt and implement modernised secured transactions legislation.[38] The EBRD has, in fact, expanded its reach and is currently active in over thirty countries.[39] Although the EBRD operates as a commercial bank, it also has a developmental mission, which creates an opportunity to influence government policy which, of course, extends to secured transactions law reform.[40]

The primary EBRD instruments include the EBRD Model Law on Secured Transactions (EBRD Model Law) and the EBRD Core Principles for a Secured Transactions Law (EBRD Core Principles).[41] The EBRD Model Law was adopted in 1994 and the EBRD Core Principles in 1997.[42] The EBRD Core Principles were adopted as a result of the realisation that core principles would produce the specific *ethos* required for secured transactions law reform.[43]

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37 See the history of the EBRD available at https://www.ebrd.com/who-we-are/history-of-the-ebrd.html (date of access: 4 April 2018).

38 F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 122.

39 Thirty-eight countries as at March 2019, which included three African countries (Morocco, Tunisia and Egypt) and six Asian countries. See 'Where we are at' available at http://www.ebrd.com/where-we-are.html (date of access: 24 March 2019).

40 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 485.

41 Initially named EBRD General Principles of a Modern Secured Transactions Law. See J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 85.

42 See J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 64-66 for the legislative history of the EBRD Model Law and the EBRD Core Principles.

43 F Dahan & J Simpson 'The European Bank for Reconstruction and Development's secured transactions project: a model law and ten core principles for a modern secured transactions law in countries of Central

Two further documents relating to principles and standards for the publicity of security rights have also been completed, but as they relate only to publicity of the charge, they are not discussed in any detail in this study.[44]

The overlap of the EBRD documents and UNCITRAL Guide's key policy objectives discussed in Chapter 3 *supra*, is highlighted *infra*. This overlap in objectives is understandable given that the EBRD documents formed the foundation for the drafting the UNCITRAL Guide.[45] This overlap may also be indicative of universality between what constitutes key objectives of a secured transactions law framework. The EBRD Core Principles include those aspects which are central to secured transactions, albeit in a more basic level than the EBRD Model Law.[46] The EBRD Core Principles contain 'legal reform goals'[47] which make the purpose of these principles similar to that of the key policy objectives included in the UNCITRAL Guide where the detailed legal rules are included separately as part of the fundamental principles of the Guide.[48]

The terminology used in the EBRD Model Law differs from that contained in UCC Article 9 and PPSA jurisdictions. For example, the EBRD Model Law also uses the term 'charge' for the security device and includes the unpaid vendor's charge as the functional equivalent of a 'purchase money security interest' or an 'acquisition finance security right'.

A practical benefit of the EBRD Model Law is that the adopting country need not integrate all the principles of the EBRD Model Law.[49] A country can 'pick and choose' (selective borrowing) those provisions suited to its specific legal tradition,[50] while still enforcing country-specific policy objectives. As with the approach of the UNCITRAL framework, the discussion *infra* is couched in a manner denoting that the EBRD Model Law

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and Eastern Europe (and elsewhere!)' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 101 and 102.

44 This includes two EBRD documents: Publicity of Security Rights. Guiding Principles for the Development of a Charges Registry (2004) available at https://www.ebrd.com/downloads/legal/secured/pubsec.pdf (date of access: 24 October 2018) and the Publicity of Security Rights: Setting Standards (2005).

45 Introduction of the UNCITRAL Guide para 12 at 3. See also J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 479.

46 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 485.

47 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 485.

48 See Chapter 3 paragraph 3.3.2 *supra* concerning the nature of the key objectives of the UNCITRAL Guide.

49 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 116.

50 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 116.

and the Core Principles are recommendations of what is regarded as ideal law and do not amount to adopted law.

4.2.2 EBRD Core Principles for Secured Transactions Law

Even though the EBRD Model Law was adopted first and is better known than the EBRD Core Principles,[51] the Model Law operates more effectively where its principles are considered within the context of the *ethos* established by the core principles.[52] The EBRD Core Principles essentially 'provide a catalogue for the legal efficiency of a secured transactions law'.[53] The purpose of the EBRD Core Principles corresponds to the UNCITRAL key policy objectives, as both provide possible legal reform goals for a reforming country. Accordingly, the principles are broad so as not to impose a definite solution on the reforming country, but rather to suggest what is regarded as an ideal outcome.[54] At the core of these principles is the assumption that secured transactions law fulfils an economic function.[55] The conclusion on the economic function corresponds to the conclusion reached in Chapter 1 of this thesis – economic efficiency is an element required for the secured transaction law framework to be legally efficient.[56]

According to Röver, the EBRD Core Principles can be divided according to the following three key areas: (1) the purpose fulfilled by the security and the objectives of legal reform;[57] (2) the efficacy of security law, hence its ability to achieve the intended purpose (the legal

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51 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 485.

52 F Dahan & J Simpson 'The European Bank for Reconstruction and Development's secured transactions project: a model law and ten core principles for a modern secured transactions law in countries of Central and Eastern Europe (and elsewhere!)' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 101 and 102.

53 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 492.

54 Preamble to the EBRD Core Principles for Secured Transactions Law (unpaginated). Also see, F Dahan & J Simpson 'The European Bank for Reconstruction and Development's secured transactions project: a model law and ten core principles for a modern secured transactions law in countries of Central and Eastern Europe (and elsewhere)' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 102.

55 Preamble to the EBRD Core Principles for Secured Transactions Law (unpaginated). Also, see F Dahan & J Simpson 'The European Bank for Reconstruction and Development's secured transactions project: a model law and ten core principles for a modern secured transactions law in countries of Central and Eastern Europe (and elsewhere)' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 101.

56 See Chapter 1 paragraph 1.2 *supra*.

57 Contained in principle 1. See J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 492 and J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 86.

function);[58] and (3) the motivation to use the 'security in the widest possible range of circumstances'.[59] The ten core principles, as divided into the three areas identified by Röver, are discussed briefly.

4.2.2.1 The purpose fulfilled by security and the key objectives of legal reform

Principle 1 relates to the *economic* purpose behind secured transactions law reform.[60] Security must be able to reduce the risk of giving credit, resulting in more credit becoming available on improved terms.[61] This principle is similar to the UNCITRAL key policy objective that where secured credit is more readily available, the cost of credit will be lower.[62] The principle also links to the economic justification for taking security, namely that holding security reduces the creditor's risk (thus it fulfils a specific legal function).[63] Again, the link between economic efficiency and legal efficiency is emphasised.

4.2.2.2 Efficacy of security law in general: achieving the intended purpose

The fundamental nature of the security right directly influences the efficiency of the security law framework. Therefore, according to principle 2, the law should allow the 'quick, cheap and simple creation of a proprietary security right' without dispossessing the debtor of her asset. In other words, an effective non-possessory security device is an essential element of an effective secured transactions law framework. It is not economically sound to dispossess the debtor of an income-generating asset which would allow her to pay off the debt. Also, where there is a

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58 Principles 2, 4 and 6 address this main area. See J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 492 and J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 87-88. This corresponds to the legal function, one of the elements of legal efficiency, explained in Chapter 1 paragraph 1.2 *supra*.

59 Principles 3, 5, 7, 8 address this main area. See J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 492 and J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 88-90.

60 According to J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 492, this principle is a summary of the micro- and macro-economic functions of security. Also see Chapter 1 paragraph 1.2 *supra* as regards the link between legal efficiency and economic efficiency.

61 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 86, 87.

62 Recommendation 1(*a*) of the UNCITRAL Guide as discussed in Chapter 3 paragraph 3.3.2(*a*) *supra*.

63 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 86-87.

delay in creating the security right, there is a delay in using the asset to generate income to service the debt.

This principle is similar to the UNCITRAL key policy objective that the creation of a security right must be simple and efficient.[64] Simplicity should be interpreted to mean adequate to achieve an intended purpose – it does not mean a 'dumbed down' version of security. There is no separate discussion under the EBRD Core Principles on the creation and third-party effectiveness, as creation takes place at the time of publicity of the charge (excluding the unpaid vendor charge that requires no publicity). In terms of principle 2, the security right is a proprietary right which is effective against all third parties. The general EBRD approach is that the security right exists as from registration or transfer of possession. The exception to this general approach is the unpaid vendor's charge which requires no publicity. It is clear that the EBRD Model Law does not support the advance registration of a security right included under the UNCITRAL Guide.[65] Consequently, registration is the constitutive element or, put differently, it is an element required for the *creation* of the *registered* charges and *enterprise* charges. Also, the transfer of possession of the collateral is the constitutive element for the creation of a *possessory* charge.

The cost of creating the charge must not result in the debtor being unable to provide security. Consequently, principle 6 requires that the cost to take and maintain the security must be as low as possible (probably as this cost is usually passed on to the debtor). In addition, the cost of *enforcing* the security must also be low. This principle is broader than principle 2 which talks only to the cost of *creating* the security right. There is no equivalent under the UNCITRAL key policy objectives relating to the maintenance of the asset, but cost-effective enforcement would also fall under the objective of efficient enforcement mentioned in principle 4 of the EBRD Core Principles. The efficiency of the enforcement process influences the loan-to-value ratio which the creditor will be comfortable with[66] and ultimately influences how

64 Recommendation 1(*c*) of the UNCITRAL Guide as discussed in Chapter 3 paragraph 3.3.2(*c*) *supra*.

65 Advance registration is alsopermitted under the Cape Town Convention. Advance registration essentially reserves a priority while the negotiations on the terms of the security agreement take place. See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 186.

66 Loan-to-value denotes the amount of debt the creditor is willing to advance relying on the value of the collateral.

many assets the debtor needs to provide as security to satisfy the creditor.

Enforcement procedures should allow 'prompt realisation' of the asset at market value in terms of principle 4.[67] Accordingly, enforcement must be quick, and the assets should be sold at market value. This goal is also included in the broad scope of the UNCITRAL key policy objective that enforcement must be efficient.[68]

4.2.2.3 Using the security in the widest possible scope of circumstances

The EBRD Core Principles expect that a certain degree of contractual flexibility must be allowed. Consequently, principle 10 deals with party autonomy. In this regard, parties should be able to structure their security to fit the specific objective achieved through a particular secured transaction. However, this flexibility should only extend 'as far as possible', meaning that the required protection should ensure that the parties will not be *unfairly* prejudiced by the transaction.[69] This principle corresponds to the UNCITRAL key policy objective that parties must have maximum flexibility to negotiate terms of the security agreement that best suits them (party autonomy).[70]

The application of the security framework regarding types of asset, obligations, and parties, should be comprehensive and take account of the commercial context of financing. For that reason, principle 7 recommends a comprehensive scope of application.[71] This scope relates to the *type* of assets that may be used to secure any *debt* between all types of *person*.[72] Also, a general, rather than an overly specific description of the charged property is suggested. It must be possible to secure any type of debt, present or future, or a claim that can be expressed in monetary terms, and any person permitted by law (individual or entity) must be able to transfer

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67 In terms of the EBRD Model Law the enforcement right is very broad and relies, in the first instance, on self-help with a right available in favour of a party claiming to have suffered damages from such enforcement to apply to a court.

68 Recommendation 1(*h*) of the UNCITRAL Guide as discussed in Chapter 3 paragraph 3.3.2(*h*) *supra*.

69 F Dahan & J Simpson 'The European Bank for Reconstruction and Development's secured transactions project: a model law and ten core principles for a modern secured transactions law in countries of Central and Eastern Europe (and elsewhere)' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 103.

70 Recommendation 1(*i*) of the UNCITRAL Guide discussed in Chapter 3 paragraph (i) *supra*.

71 This principle links to the UNCITRAL key objective that the debtor must be able to use the full-inherent value in her assets (recommendation 1(*b*)). However, this links directly to the UNCITRAL Guide's fundamental policy that an instrument must have a comprehensive scope discussed in Chapter 3 paragraph 3.3.2 (*b*) *supra*.

72 This objective is fulfilled by certain principles in the EBRD Model Law. It is possible to register an enterprise charge over all the assets and rights owned by the debtor. Moreover, the definitions of secured debt and charged property are very flexibility and extend to future property.

security to another.[73]

A comprehensive scope is not possible without an effective means of publicity. As a result, principle 8 requires an effective method for publicising that the charge exists (excluding, of course, the unpaid vendor's charge).[74] Possession, public registration, and other notification systems are suggested methods for publicity, but the choice of method depends on whether or not the parties intend to create a non-possessory security right.[75] The purpose of this principle is similar to the UNCITRAL key objective of improving certainty and transparency by using a general registry.[76] Due to the importance of principle 8 under the Core Principles, which principle relates to publicity, two additional documents containing principles and standards for publicity were published by the EBRD. The EBRD Guiding Principles for the Publicity of Security Rights, published in 2004, sets out a practical approach to effective publicity.[77] In 2005, the EBRD also published the Publicity of Security Rights: Setting Standards.

The EBRD Core Principles also stress that it must be possible to create non-possessory security. Consequently, under principle 2 it must be possible to take security in an asset without dispossessing the debtor of the asset. Nevertheless, it should remain possible to use a possessory charge as an alternative, along with a registered charge.

In the case of a competing limited property rights, the priority rules must be clear and simple. Principle 9 provides 'that the law should establish rules governing competing rights of persons holding security and other persons claiming rights in the assets given as security'. This principle is similar to the UNCITRAL key objective which recommends clear and predictable priority rules.[78] This principle also implies set priority rules. The general rule is that the time of creation or deemed creation will determine priority. However, policy considerations in the adopting country can result in exceptions similar to those identified for the UNCITRAL framework in Chapter 3 *supra*.[79]

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73 The principles do not mention that any type of person should be able to borrow funds against collateral, but the assumption is that this can be implied. The corresponding key policy objective of the UNCITRAL Guide is to ensure equal treatment of all types of creditor (recommendation 1(*d*) of the UNCITRAL Guide).

74 This principle is expanded on in the EBRD Guiding Principles for the Publicity of Security Rights.

75 The other notification system is, for example, the notice sent to prior secured creditors in case of the unpaid vendor's charge. It is a contentious issue that the unpaid vendor's charge affords super-priority to its holder without having to be registered in the registry.

76 Recommendation 1(*f*) of the UNCITRAL Guide as discussed in Chapter 3 paragraph 3.3.2(*f*) *supra*.

77 This document is available at http://www.ebrd.com/downloads/legal/secured/pubsec.pdf (date of access: 2 August 2018).

78 Recommendation 1(*g*) of the UNCITRAL Guide discussed in Chapter 3 paragraph 3.3.2(*g*) *supra*.

79 Article 17.1 of the EBRD Model Law.

Effective enforcement depends on clear priority rules. In terms of principle 3, where the secured debt is not paid the security holder must be able to realise the charged assets to make the proceeds available to satisfy the chargeholder's claim before discharging the claims of competing creditors. Further, it must be possible to enforce the security right after the insolvency of the debtor. Therefore, principle 5 provides that the security right should continue in effect after the insolvency (bankruptcy) of the debtor. This principle avoids the value of the security being diluted by an insolvency procedure. Accordingly, as the security right is a proprietary right, the right continues after the insolvency of the debtor.[80] However, the principle allows for exceptions in the form of a moratorium against the claims of creditors where it would be beneficial to preserve the entity so that it may be sold as a going concern (in the case of an enterprise charge).[81] There is no such equivalent key policy objective under the UNCITRAL Guide.[82]

The interaction between the EBRD Core Principles and EBRD Model Law is best described as the Model Law offering one option for the implementation of the Core Principles. What follows is a discussion the key features of the EBRD Model Law followed by the fundamental principles (policies) forming the building blocks to achieve the EBRD Core Principles.

4.2.3 EBRD Model Law

4.2.3.1 Introduction and key features of the EBRD Model Law

The Model Law is not intended to be 'a complete law for turn-key incorporation into local law'. It is rather a template or foundation that must fit in with the national property, contract, and insolvency laws[83] (be able to fit-to-context). The nature of this type of Model Law differs from that of the UNCITRAL Model Law (a more comprehensive document). The drafters of

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80 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 90.

81 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 90. See also, F Dahan & J Simpson 'The European Bank for Reconstruction and Development's secured transactions project: a model law and ten core principles for a modern secured transactions law in countries of Central and Eastern Europe (and elsewhere)' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 102.

82 However, Chapter XII of the UNCITRAL Guide deals with the impact of insolvency on a security right. Also, the UNCITRAL Guide arguably does not include a specific key objective as the Guide did not wish to repeat the objectives which form part of the UNCITRAL Legislative Guide on Insolvency Law.

83 J-H Röver 'An approach to legal reform in Central and Eastern Europe: The European Bank's Model Law on Secured Transactions' (1999) 1 *Eur JL Reform* 119 at 124.

the Model Law intended the document to be easy to read – a concise document rather than 'detailed legislation'.[84] The basic framework reflects that the general central themes of the EBRD Model Law can only fit into a domestic framework where the basic Model Law text is adapted and refined, using the domestic law as the basis for the reform.[85] The Model Law allows sufficient flexibility to be adapted to fit any legal jurisdiction – be it grounded in a civil- or common-law tradition.[86] The intention is that countries at different stages of secured transactions law reform should all be able to use the Model Law for secured transactions law reform.[87]

Other than the UNCITRAL Guide and UNCITRAL Model Law, the EBRD Model Law was prepared by a '*financial* organisation which is also a commercial bank' (emphasis added).[88] This factor probably contributed to the practical and economic relevance of the document. As the originator of this Model Law – the EBRD – is itself a creditor, it is submitted that the underlying policy of the Model Law can be classified as creditor-driven.[89]

The EBRD Model Law consists of thirty-five articles,[90] divided into five parts[91] and two schedules.[92] It uses a 'single security right' in the form of a charge, but this concept is broader than a mere security interest.[93] The EBRD Model follows a 'formal' rather than a 'functional'

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84 Introduction to the EBRD Model Law (unpaginated); J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 486 and NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 10.

85 Introduction to the EBRD Model Law (unpaginated). Also, see J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 67.

86 Introduction to the EBRD Model Law (unpginated). See also D Fairgrieve 'Reforming secured transactions laws in Central and Eastern Europe' (1998) July/August *Eur Bus L Rev* 254 at 256 where the Model Law is described as a guide to legislators with different needs (be they domestic or international investors) and legal traditions. Further, see NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 10. Then also see F Dahan 'Law reform in Central and Eastern Europe: the 'transplantation' of secured transactions law' (2000) 2 *Eur JL Reform* 369 at 376.

87 D Fairgrieve 'Reforming secured transactions laws in Central and Eastern Europe' (1998) July/August *Eur Bus L Rev* 254 at 257.

88 F Dahan & J Simpson 'The European Bank for Reconstruction and Development's secured transactions project: a model law and ten core principles for a modern secured transactions law in countries of Central and Eastern Europe (and elsewhere!)' in E-M Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004) at 100.

89 For example, the EBRD Model Law is the only instrument discussed in this thesis, where the enforcement measures clearly amount to self-help. Self-help is a clear creditor-driven measure.

90 The Model Law is accompanied by commentary that provides short explanations to each article.

91 Part 1 contains general provisions while the creation of a charge is dealt with in Part 2. Part 3 deals with third-party effectiveness and part 4 includes provisions on enforcement and termination of the charge. Part 5 sets out the registration requirement for the charges.

92 The schedules prescribing templates for the charging instrument and the registration instrument.

93 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 75.

approach.[94] The charge can be taken over *all* things and rights, but in line with a formal approach, there are different types of charge (discussed *infra*). The commentary to article 1 defends the use of the concept of a charge as opposed to the common trend of opting for the unitary concept. A 'charge' is preferred as this is the most general and neutral English term which extends to consensual security rights. Thus, even though the Model Law uses the term 'charge', the charge under the EBRD Model Law should not be confused with the 'floating charge' of English law.[95] However, at a later point, the EBRD text also uses the term 'pledge', not to denote the narrow interpretation followed, for example, in South African law, but rather as a broader concept where the legal implication is similar to that achieved under an English-law charge.[96]

There is a reasonable amount of flexibility as to the transactions included within the EBRD Model Law's scope. The general methodology is that any person can grant a charge to any person (not only a financial institution) provided that the charge forms part of a 'business activity'.[97] Furthermore, the flexible definitions of the key concepts 'charged property' and 'secured debt', ensures the Model Law's flexibility instrument without the need for resort to the unitary concept to reclassify all security as a security right (or interest). The chargeholder has wide powers during enforcement and the parties have the flexibility to arrange the transaction as they deem fit.

The EBRD Model Law does not use the terms 'fundamental policies' or 'fundamental principles', but in its introduction it refers to 'essential features' of the EBRD Model Law. These features are referred to as the foundation of the EBRD Model Law and are functionally equivalent to the fundamental principles that form part of the UNCITRAL framework.

4.2.3.2 EBRD Model Law: fundamental principles (policies)

According to Röver, ten key concepts form the foundation of the EBRD Model Law.[98] For purposes of this study, these concepts are taken to correspond to the notion of 'fundamental

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94 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 47. See also J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 72, 75.

95 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 76.

96 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 110.

97 Articles 2 and 3.1 of the EBRD Model Law.

98 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 496.

principles' used in the discussion of the UNCITRAL Guide and Model Law in Chapter 3 *supra*.[99] The introduction to the EBRD Model Law refers to nine key features, eight of which correspond to the concepts proposed by Röver. However, Röver adds a principle to the EBRD key features – the protection of an acquisition finance creditor – while the EBRD Model Law has added a general principle to those suggested by Röver – that practical matters, which often cause complications in secured transactions law reform, need to be considered.[100]

According to McCormack, the EBRD Model Law has only five key elements: (1) the security right must comply with the essential requirements of a property right; (2) it must be possible under the law to grant a security under the widest possible circumstances; (3) the fact that there is security in the property must be publicised effectively; (4) the means of recovery of debt must be quick and cost-effective; and (5) in general, the cost involved in the creation, maintenance, and enforcement of the security right should be kept within reason. [101]

As the principles suggested by Röver are more comprehensive and similar to the EBRD key features, they are used as the fundamental principles for purposes of the discussion *infra*. As was the case in the discussion of the EBRD Core Principles, reference to the corresponding fundamental principles in the UNCITRAL Guide is included. Two aspects absent from Röver's list are the idea of 'clear and predictable priority rules' and the unequal treatment of different types of creditor as part of the same framework. Therefore, the fundamental principles listed under items (*k*) and (*j*) *infra,* are added to Röver's list.

(a) Comprehensive scope: the ability of any party to use all assets to secure all types of obligation

Unlike UCC Article 9 and the UNCITRAL Guide and Model Law, the EBRD Model Law extends to movable *and* immovable property. The principle resembles the logical approach that secured finance transactions are usually structured using a wide bouquet of the debtor's assets, the most valuable often being immovable property.[102] Nevertheless, in line with other secured

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99 There may be some overlap also to the key objectives. Nevertheless, as the EBRD Model Law is more substantive, the provisions loosely resemble the recommendations to the UNCITRAL Guide and more closely the UNCITRAL Model Law.

100 Introduction to the EBRD Model Law (unpaginated).

101 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 107, 108.

102 I submit that that the Eastern European countries also did not have properly functioning immovable property frameworks, so the inclusion of a proposed framework in terms of the EBRD Model Law makes sense.

transactions law reform initiatives, it is arguably more realistic for a country to reform its system for immovable property separately. This study, therefore, only focuses on the aspects of the EBRD Model Law relevant to movable property.

The Model Law aims to create a *single category* of security rights applicable to all types of thing and right but in the form of a charge. The implication of having a single security right is that certain provisions of the Model Law apply to all charges under the Model Law.[103] The EBRD Model Law was inspired to some extent by the English 'floating charge',[104] but the concept is not entirely the same. Consequently, the EBRD Model law does not use the unitary concept of either a security interest (or right).[105] Instead, the EBRD Model Law's approach is commercially facilitative.[106] The EBRD Model distinguishes between the following types of charge: the registered charge; the possessory charge; the unpaid vendor's charge (the functional equivalent of PMSI under UCC Article 9 and similar to a simple retention-of-title clause);[107] and the enterprise charge (which is the floating security device and the functional equivalent of the 'all-asset' security under the UNCITRAL framework).[108] Accordingly, unlike the functional approach followed by UCC Article 9 and the UNCITRAL instruments, the EBRD Model Law follows a formal approach.[109]

Article 5 contains the general provisions regarding the types of asset allowed as charged property. First, a charge can encumber multiple rights or things, which will collectively be referred to as 'charged property'.[110] Accordingly, the charge may be granted over any 'thing' or 'right'. The EBRD Model Law does not mention direct application to 'proceeds' but contains a more general description of a right or a thing 'attached or related to the charged property' but

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103 General provisions of the Model Law (arts 1-5), the provisions concerning third-party involvement (arts 17-21), and enforcement provisions (arts 22-32).

104 S van Erp 'Comparative property law' in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) at 1067.

105 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 496 and J-H Röver 'An approach to legal reform in Central and Eastern Europe: the European Bank's Model Law on Secured Transactions' (1999) 1 *Eur JL Reform* 119 at 126.

106 I coned this phrase to denote a framework conducive to commercial activities. See Chapter 5 paragraph 5.4.1(*a*) *infra*.

107 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 496.

108 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 108.

109 This is also referred to as the divide between a facilitative and formal approach. See S Saidova *Security Interests under the Cape Town Convention on International Interests in Mobile Equipment* (2018) at 32. There is debate as to whether the approach is not more formal than functional. See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 47 and the source listed at n 166.

110 Article 5.1 of the EBRD Model Law.

adds that the attached or related thing or right is 'included with the charged property by operation of law'.[111] To include a thing or right which 'is attached or related to the charged propert' creates the impression that a charge potentially extends to a mass or product, where the charged property has either been commingled or forms a component of a new product. However, it is questioned whether this provision is not too vague to allow that the charge extends to a newly-formed movable property. However, this 'vagueness' may be intentional so as to allow domestic law to be adapted (if so decided) to extend the charge to a mass or a product. Also, the charged property may include 'a changing pool of present and future assets', as a result of it being possible to identify the charged property either specifically (a specific charge) or generally (a class charge).[112] Further, extending a charge in respect of things and rights not yet owned by the charger when the charge is created, draws in future assets.[113] Where the chargor then acquires the future assets, it is deemed that the charge was created: (1) in case of a registered charge, at date of registration; (2) in case of the unpaid vendor's charge, when the title of the charged property was transferred to the purchaser; and (3) in case of a possessory charge, the later date of either the date of signature of the charge instrument or transfer of possession of the charged property.[114]

The Model Law is not prescriptive in the sense that it applies only to certain types of creditor[115] – eg, it is not reserved exclusively for financial institutions.

(b) The security right should comply with the essential qualities of a property right

A security right should ideally be a right in the property not merely a personal right against the debtor.[116] This means that the right should be enforceable *erga omnes.* Accordingly, the charge under the EBRD Model Law qualifies as a limited right in property, not merely a personal right

111 Article 5.2 of the EBRD Model Law.
112 Article 5.5 of the EBRD Model Law.
113 Article 5.8 of the EBRD Model Law.
114 Article 6.7 of the EBRD Model Law.
115 Article 3.1 of the EBRD Model Law.
116 This is also a fundamental element according to McCormack. See G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 108. See also J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 76, and J-H Röver 'An approach to legal reform in Central and Eastern Europe: The European Bank's Model Law on Secured Transactions' (1999) 1 *Eur JL Reform* 119 at 127.

against the debtor.[117] The chargor can only sell the encumbered assets to satisfy the secured debt, and it is generally not possible for third parties to acquire the asset without the charge.[118]

Being a property right, the charge is not created contractually, but also requires a constitutive action for third-party effectiveness – save for the right under the unpaid vendor's charge, which requires no publicity to be effective against third parties. According to Röver, the charge holds certain proprietary qualities: (1) that an asset cannot be acquired free from a charge, albeit there are specific exceptions to the general principle; and (2) that the charge creates priority upon the debtor's insolvency against creditors who do not hold a charge.[119]

Registration is the constitutive element to create a registered charge (art 6.2), while possession is the constitutive element in the case of a possessory charge (arts 6.4 and 10.1). Unlike the position under the UNCITRAL Guide and the UNCITRAL Model Law, the EBRD Model Law does not distinguish between creation and third-party effectiveness.

(c) Securing business credit exclusively

Even though it is not listed in the EBRD Core Principles, the EBRD Model Law only applies to business transactions.[120] A country embarking on reform on the basis of the EBRD Model Law should have adequate consumer protection laws in place for the provisions of the Model Law to be able to apply to personal and consumer transactions.[121] Accordingly, it is entirely possible to extend the scope of the Model Law to include consumer transactions, but subject to a reforming country having an effective consumer law framework. The policy consideration

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117 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 496. See also, NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 136.

118 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 496 and J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 77.

119 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 497 and J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 77.

120 In terms of art 2, any person can grant a charge as long as it forms part of her business and is only over things or rights used for this business activity. See also J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 77 and J-H Röver 'An approach to legal reform in Central and Eastern Europe: The European Bank's Model Law on Secured Transactions' (1999) 1 *Eur JL Reform* 119 at 127.

121 Introduction to the EBRD Model Law: Several features of the Model Law (no page numbers indicated).

behind this limitation is that the law applicable to businesses is the area most in need of reform in transitional economies.[122]

(d) Flexibility: defining the secured debt and charged property

The specificity principle used to describe collateral is particularly relevant in civil-law countries. However, it is difficult to reconcile the application of the specificity principle with being able to take security in future assets or assets of a revolving nature.[123] A floating charge is a security device used by common-law jurisdictions to overcome this limitation. Similarly, the EBRD Model Law uses different types of charge as security devices, which is essentially a common-law approach. Although the different types of charge operate with a similar level of flexibility as the English floating charge, these concepts should not be regarded as synonymous.

The Model Law contains a flexible definition of a 'secured debt' and a 'charged property'. The secured debt may be described either specifically or generally[124] and as either conditional or future.[125] The charged property may be described either specifically or generally.[126] Where charged property is described specifically, a *specific* charge is created;[127] where it is described generally, this will create a *class* charge. This is particularly relevant when dealing with revolving assets – inventory, for example.[128] A distinctive feature of the EBRD Model Law is that it allows for a charge to be taken over all the assets of an enterprise and even allows for the additional remedy in terms of which the enterprise may be sold as a going concern when a debtor defaults.[129] An enterprise charge can only be created by a corporate entity,[130] which is also the case with an English floating charge.

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122 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 108. See also, J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 77.

123 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 497.

124 Article 4.3.2 of the EBRD Model Law. See also J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 497.

125 Article 4.3.3 of the EBRD Model Law.

126 Article 5.5 of the EBRD Model Law and NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 137.

127 Article 5.5 of the EBRD Model Law. This is similar to a special notarial bond under South African law.

128 Article 5.5 of the EBRD Model Law. This is similar to a general notarial bond under South African law.

129 Introduction to the EBRD Model Law (no page numbers indicated). Also see art 5.6 of the EBRD Model Law. The enterprise charge is similar in nature to the English floating charge. See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 137.

130 Article 6.6 of the EBRD Model Law. In the commentary to art 6.6, the reason put forward is 'strong policy arguments' which can only be assumed to relate to the risk of individual insolvency.

A charge under the EBRD Model Law is created subject to the following requirements: the chargor actually owns the charged property; the chargor holds the power to grant the charge when the charge is created or, in the case of future property, is *deemed to be created*; and the charge only secures *debt* (ie, an obligation which can be translated into monetary terms).[131] Where a charge is registered over future property, the date of creation is *deemed* to be the date of registration of the charge. Thus, the priority ranking is also determined retrospectively, as the charge only exists once the chargor obtains or owns the things or rights.[132]

Unlike the UNCITRAL Guide, under the EBRD Model Law the charge does not automatically extend to the proceeds of the charged property.[133]

(e) Charges must be registered in a public register

Registration is the main means of publicity under the EBRD Model Law. Indeed, as the EBRD Model Law was inspired by a commercial need, having a debtor surrender the income-generating asset to a creditor makes no sense.[134] However, for two types of charge – the possessory charge and the unpaid vendor's charge – registration is not required. The possessory charge is created when the chargor and chargeholder enter into the charging instrument *and* possession of the charged property is given to the chargeholder, or a person who must hold the property on her behalf.[135] This transfer of possession can take place 'before or after the date of the charging instrument'.[136] However, the application of the possessory charge is wider than that of the traditional pledge. Unlike a traditional pledge, under the charge loss of possession has no legal implications.[137] Continued possession of the charged property is consequently not required for a possessory charge.

A registered charge is created when registration takes place. The registered charge requires that the chargor and chargeholder enter into the charging instrument *and* that this

131 Article 6.5 of the EBRD Model Law.
132 Article 6.8 of the EBRD Model Law.
133 Commentary to art 5.10 of the EBRD Model Law.
134 See also J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 78.
135 Articles 6.4 and 10 of the EBRD Model Law.
136 Article 10.1 of the EBRD Model Law.
137 The concept of constructive possession applies in the case of a possessory charge. See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 194.

charge is subsequently registered in the charge registry.[138] The information on the charged property and the charged debt is elaborated on in two registration documents: the charging statement; and the registration statement.[139] The charge statement must be registered at the charge registry within thirty days of its execution.[140] Unlike under the UNCITRAL Guide, the charge is *created* when it is registered resulting in creation and third-party effect taking place simultaneously.[141] Advance filing (filing before the charge instrument has been concluded) is not possible under the EBRD Model Law. Any person should be able to gain access to the registry system and receive a copy of the entry, subject to the payment of the required fee.[142]

Article 7 of the EBRD Model Law prescribes the information that must form part of the written charge instrument. The charge instrument must include the identification of the chargor and chargeholder; the specific or general description of the debt; the specific or general description of the charged property; and the signatures of *both* parties.[143] Further, the charge instrument must include an express statement that the parties intend to create a charge, or this intention must be implied from the wording of the charge instrument.[144]

(f) Acquisition financier to be protected: unpaid vendor's charge

An unpaid vendor's charge is the functional equivalent of an acquisition security right (in terms of the UNCITRAL framework) and a PMSI (as per UCC Article 9). The unpaid vendor's charge was an attempt to use a uniquely European approach, similar to the approach to a retention-of-title device.[145] The unpaid vendor's charge requires a written agreement containing a provision that the vendor either: (1) retains title of the thing; or (2) holds a security right in the property until the purchase price is paid in full (in the latter option, ownership is transferred to the purchaser).[146] Thus, regardless of which one of the instances is included in

138 Article 6.2 of the EBRD Model Law. This differs from the UNCITRAL Guide and Model Law as well as the OAS Model Law where the security right is created when the parties enter into the security agreement.
139 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 179.
140 Article 8.1 of the EBRD Model Law.
141 In case of the Guide the security right exists from the time there is a valid security agreement and registration only influence third-party effectiveness. The approach of the EBRD Model law is similar to UCC Article 9.
142 Article 35 of the EBRD Model Law.
143 Under the OAS Model Law only the signature of the debtor is required. There is no mention of signatures under the UNCITRAL instruments. The signatures of both parties confirm this intention to create a charge.
144 Article 7.4 of the EBRD Model Law.
145 A Veneziano 'A secured transactions' regime for Europe: treatment of acquisition finance devices and creditor's enforcement rights' (2008) 14 *Juridica Int'l* 89 at 91.
146 Article 9.1 of the EBRD Model Law.

the reservation clause, the unpaid vendor receives an unpaid vendor's charge and the title passes to the purchaser. This charge need not be registered and a charge instrument need also not be concluded (although a written agreement is required),[147] unlike other legal instruments discussed in Chapters 3 (acquisition security right under the UNCITRAL instruments) and 4 (acquisition security interest in terms of the OAS Model Law) of this study which require registration of acquisition security rights.

The fact that the charge is not registered may be problematic for third parties, especially as the rights associated with an unpaid vendor's charge enjoy priority over rights associated with other charges.[148] However, this type of charge is only valid for six months unless the charge is transformed into a registered charge.[149] The higher priority ranking also does not extend to the proceeds from the charged property.

Moreover, it appears as if the unpaid vendor's charge applies to the *seller* of goods only, which means that the *lender* who advanced funds to purchase goods, will have to use a *registered* charge. Accordingly, the different types of creditor under the EBRD Model Law are not all treated alike, unlike the equal treatment afforded to all types of creditor under the UNCITRAL Guide and UNCITRAL Model Law.[150]

(g) Transfer of the charged property free from the charge

In line with exceptions – which also apply in most domestic jurisdictions – it is possible to transfer the charged property free of the charge under certain circumstances. This is possible where the transfer takes place in terms of a sale (or transfer) in the ordinary course of business;[151] if it applies to certain assets which are subject to an enterprise charge; or if the parties agreed that the chargor is free to deal in the charged property under a consensual contractual licence.[152]

(h) Enforcement measures in terms of the EBRD Model Law

147 Article 9.1.2 of the EBRD Model Law.
148 Article 17.3 of the EBRD Model Law.
149 Article 9.4 of the EBRD Model Law.
150 Chapter 3 paragraphs 3.3.3.11 and 3.3.4 *supra*.
151 The exception is especially relevant to revolving assets, eg, stock-in-trade.
152 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 499 and J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 79.

Common-law jurisdictions tend to allow out-of-court enforcement more readily than civil-law jurisdictions.[153] The EBRD Model Law follows the common-law approach with strong emphasis on out-of-court enforcement. Enforcement may even amount to self-help as no consent to enforcement is required from the debtor.[154] The default event is the failure to pay the secured debt.[155] The enforcement process commences when the chargeholder delivers an enforcement notice to the chargor.[156]

There is a sixty-day waiting period, following the delivery of the default notice, before enforcement may commence.[157] This extended waiting period justifies the conclusion that the EBRD Model Law enforcement measures hardly qualify as quick. However, the extended waiting period in itself does not render the mechanism cumbersome. The chargeholder can take *immediate* possession of the asset and then *dispose* of the asset when, after sixty days, the chargor has not settled the outstanding amount and all these steps take place *without* court intervention.[158]

The discussion of enforcement *infra* is divided into two parts. The first addresses immediate dispossession as a 'protective measure' available to the chargeholder. The second concerns the realisation of the property at a 'fair' price without court intervention, once the sixty-day period after delivery of the default notice has lapsed. The discussion of enforcement in the case of an enterprise charge is reserved for the general paragraph dealing with an enterprise charge *infra.*

The charge becomes enforceable *immediately* once: (1) the debtor fails to pay the secured debt; (2) subject to the debt being immediately payable;[159] and (3) the charge has become enforceable.[160] When the debt becomes immediately enforceable, enforcement proceedings commence with the delivery of the *written* enforcement notice to the debtor. The written default notice must contain specific information.[161] Firstly, the notice must identify the specific charge being enforced. The method of identification of the specific charge depends on whether it is a

153 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 499.
154 See Chapter 2 paragraph 2.3.3.3(*f*) *supra* on the meaning of 'self-help'.
155 Article 22.1 of the EBRD Model Law.
156 J-H Röver 'An approach to legal reform in Central and Eastern Europe: The European Bank's Model Law on Secured Transactions' (1999) 1 *Eur JL Reform* 119 at 129.
157 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 115.
158 Settlement of the amount due is the only defence available to the chargor.
159 'Immediately payable' has the meaning attributed to it in the banking agreements. See EBRD Comment on article 22.1.
160 Article 22.1 of the EBRD Model Law.
161 Article 22.7 of the EBRD Model Law.

registered charge, in which case the identification is done using the charge register and the registration date as reference;[162] or the unpaid vendor's charge and a possessory charge, which are identified relating to the information that would be needed to register this type of charge in the registry.[163] The enforcement notice must also state the nature of the debt that led to the enforcement proceedings.[164] The default notice must include a 'statement that the charge has become immediately enforceable'.[165] If the charge is an enterprise charge and the chargeholder decides to transfer the business as a going concern, this intention to transfer must be clearly stated and the notice must also identify the enterprise administrator who will be appointed.[166] Finally, the default notice must be signed by the chargeholder, and where an enterprise administrator has already been appointed, also by this administrator.[167]

It is possible for the chargeholder to take possession of the charged property without any court intervention. Article 22.3 refers to 'protective measures' in terms of article 23, which includes taking possession of the charged property. The chargeholder is entitled to take possession of the charged property *after* the default notice has been delivered unless the right to possession is either impractical or disputed by a third party who is in possession of the charged property.[168]

Article 22.4 refers to the continuation of the enforcement proceedings and it is assumed that this refers to the enforcement steps that take place *after* the dispossession of the charged property. In this regard, the chargeholder must register a supplementary registration statement in relation to the delivered enforcement notice within seven days of delivery of the default notice. This allows the chargor to proceed with further enforcement measures.[169] Failure to register this notice results in severe consequences for the chargeholder in that she becomes liable for *any* loss that the chargor, other chargeholders in the charged property, and any other party claiming a right in the charged property, may suffer due to the protective measures that the chargeholder takes.[170] Also, any party may approach a court to request that the enforcement notice be declared invalid.[171]

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162 Article 22.7.1.1 of the EBRD Model Law.
163 Article 22.7.1.2 of the EBRD Model Law.
164 Article 22.7. 2 of the EBRD Model Law.
165 Article 22.7.3 of the EBRD Model Law.
166 Article 22.7.4 of the EBRD Model Law.
167 Article 22.7.5 of the EBRD Model Law.
168 Article 23.3 of the EBRD Model Law.
169 Article 22.4.1 of the EBRD Model Law.
170 Article 22.5 of the EBRD Model Law.
171 Article 22.4.2 of the EBRD Model Law.

After the sixty days have lapsed, and provided that there has been compliance with the notice requirements mentioned above, the charged property may be realised (sold).[172] The chargor (the debtor) only needs to *receive* a default notice and there is no need for the debtor to *consent* to the disposition for the realisation to take place. Consequently, disposition in this form qualifies as self-help.

The chargeholder should attempt to realise a 'fair' price when the charged property is sold.[173] According to the comments to article 24.5, it is 'impractical' to be too prescriptive on what constitutes a 'fair' price.[174] What constitutes a fair price would depend largely on the nature of the encumbered asset. To not impose a strict test may create uncertainty, especially where a legal jurisdiction does not have an objective criterion to determine the meaning of 'fair' when it comes to a particular class of asset. However, article 24.5 provides factors which can be used to determine what would qualify as a 'fair' price. These factors include: (1) where the asset forms part of a recognised market, the price is determined according to the practice in this market; (2) the chargeholder must act in the same way as a prudent seller operating in the same market; or (3) where there is no recognised market, the chargeholder must have taken the steps a prudent person would, in the same circumstances, have taken to sell the charged property at a fair price. At no point is it required that the chargor must agree to the valuation method – this is left entirely up to the chargeholder.[175]

It is possible for the chargor or another chargeholder (with a charge over the same charged property) to dispute the creation, validity, or enforceability of the charge or claim, and apply to a court to declare the enforcement notice invalid.[176] Even though the application is treated as urgent, the enforcement notice continues to be valid until a court order provides otherwise. Where the court cannot make an order before the sixty-day enforcement notice period lapses, it may grant an interim order to prevent the transfer of the charged property until the final court order is granted. This interim order should be presented for registration at the registry where the charge is registered within seven days after the order has been granted.[177]

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172 Article 24.1 of the EBRD Model Law.

173 Article 24.3.1 of the EBRD Model Law.

174 In art 24.5 the obligation to obtain a fair price is fulfilled when dealing with a charged property with a recognised market, the chargeholder acted in a manner expected of a prudent person also operating in that market. In the case of all other types of asset, when steps were taken which can be expected of a prudent person in the same circumstances.

175 The OAS Model requires an independent appraisal of the value of the collateral. See paragraph 4.3.3.6 *infra*.

176 Article 29.1 of the EBRD Model Law.

177 Article 29.3 of the EBRD Model Law.

Where the applicant fails to present the order, she incurs liability to a third party who suffers *any* loss as a result of non-registration of the notice.[178]

Article 30 addresses a right to claim damages suffered as a result of the implementation of an enforcement measure. A chargor, another chargeholder in the same property, or any other person with a claim in the charged property, potentially has an action for damages under specific circumstances. The potential claim will include where an enforcement notice is declared invalid, and the loss extends to *any* loss suffered by the parties above as a result of the enforcement.[179] A loss resulting from the chargeholder, charge manager, enterprise administrator, or proceeds depository failing to comply with any of her duties relating to the enforcement process, or where this person acted outside of her authority, can be claimed.[180] Even though this article allows interested parties to approach the court in the case of loss, this does not change the reality that enforcement under the EBRD Model Law amounts to self-help. However, the EBRD Model Law is a template and, therefore, even though the enforcement rights may seem very wide, the adopting country needs to align the enforcement provisions with its national insolvency and civil procedure laws.

(i) 'All assets of an enterprise' as the charged property under an enterprise charge

Whenever the charged property is defined as 'all assets of an enterprise' the charge in question is an enterprise charge.[181] However, a class charge also qualifies as an enterprise charge where it covers those things and rights of the enterprise that are needed to run the enterprise as a going concern.[182] According to Röver, an enterprise charge has three unique features.[183] First, the general asset description refers to 'all assets of the enterprise'; second, as a result of the general asset description, revolving assets may be included; and third, the main purpose behind taking an enterprise as security is that when the debtor defaults, the chargeholder has a choice either

178 Article 29.3 of the EBRD Model Law.
179 Article 30.1 of the EBRD Model Law.
180 Article 30.2 of the EBRD Model Law.
181 Article 5.6 of the EBRD Model Law.
182 Article 5.6.2 of the EBRD Model Law.
183 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 at 500; J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 80; and J-H Röver 'An approach to legal reform in Central and Eastern Europe: The European Bank's Model Law on Secured Transactions' (1999) 1 *Eur JL Reform* 119 at 130.

to take-over and run the enterprise, or where possible, sell the enterprise as a going concern.[184] The enterprise charge would be a functional equivalent of a floating charge (under English law) or a floating lien (under UCC Article 9). The enterprise charge differs from a floating charge in two respects: (1) contra to the floating charge, under the enterprise charge there is no need for crystallisation of the security; and (2) the priority does not depend on the date of crystallisation (as is the case with a floating charge) but on the registration date.

The law is relatively uncomplicated when the business is solvent, but becomes more complex when the debtor is insolvent or if there are competing claims between creditors. Therefore, a moratorium against legal proceedings instituted by other creditors is required for the administration to function effectively and avoid the commencement of insolvency proceedings. The following paragraphs provide a general discussion of the legal nature of an enterprise charge, followed by a synopsis of the administration process instituted as a result of the enforcement of the enterprise charge.

Article 25 of the EBRD Model Law deals with the enterprise charge administration where the running of the business is taken over by an enterprise administrator. Enterprise charge administration can only take place where the chargeholder believes that the enterprise can be sold as a going concern.[185] Where the chargeholder of the enterprise charge realises that it is no longer viable to sell the enterprise as a going concern,[186] the option remains to sell the individual assets of the business. The EBRD Model Law contains no provision on whether the enterprise must be insolvent or financially distressed for an enterprise administrator to be able to take over the business. The only requirement is that the chargor must have defaulted on the loan. This lack of clear requirements may result in a solvent business that is merely going through a rough patch financially, being placed under administration. Also, the enterprise administrator need only sell the enterprise at a *fair* price.[187] A fair price would be the value of that enterprise at *that* time, including the current outstanding debt. The earning potential of the business need not be factored in.

The appointment of the enterprise administrator must be broadcasted within seven days after the notice to commence enforcement of the enterprise charge has been delivered to the

184 J-H Röver 'The EBRD's Model Law on Secured Transactions and its implications for an UNCITRAL Model Law on Secured Transactions' (2010) 15 *Unif L Rev* 479 and J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 80.
185 Article 25.4 of the EBRD Model Law.
186 Article 25.22 of the EBRD Model Law.
187 'Fair value' being the general standard for disposition under the EBRD Model Law.

chargor.[188] The enterprise administrator must manage the enterprise as a going concern to allow the business eventually to be sold as a unit. The enterprise administrator has extensive powers. For example, in terms of article 26.16 of the EBRD Model Law, the enterprise administrator may renounce a contract which imposes continuing obligations on the chargor. The administrator needs to renounce this contract within sixty days of delivery of the enforcement notice. The other contracting party potentially has a contractual claim resulting from the early termination of the contract. But, regardless of this contractual claim, the enterprise can still be transferred. As soon as the proceeds from the sale of the business are received, the contractual claim will be paid from the proceeds.[189]

Further, where the enterprise administrator has not yet renounced a contract, the other contractual party can serve a notice on the enterprise administrator asking her to confirm whether or not the administrator intends renouncing the contract. Up to the point that the enterprise administrator responds to this notice, the other contractual party has no obligation to perform under the contract.[190]

It is possible to rescind the transfer of the enterprise as a going concern, but this decision can be taken either by the chargeholder (where it is to the benefit of other creditors) or through a court decision.[191] Where the enterprise administration is terminated, a chargeholder can continue to take the same enforcement measures (protection and realisation measures) as other chargeholders, without having to wait a further sixty days, or having to deliver a new enforcement notice.

Where the enterprise is sold by the enterprise administrator, the purchaser acquires the title in the business free of *any* charge if certain conditions are met.[192] In terms of article 26.2, the purchaser does not acquire the enterprise free of charges where she had actual knowledge that: (1) the charge was never created, or is invalid or unenforceable; (2) 'the charge has ceased to be immediately enforceable'; (3) a court has declared the enforcement notice invalid; (4) the court has made an interim order to prevent that the charged property is transferred; or (5) the election to transfer the enterprise as a going concern has been rescinded. As the enterprise is not transferred free of other charges under such circumstances, other chargeholders will share in the proceeds resulting from the sale of the enterprise in the hands of the purchaser.

188 Article 25.6.3 of the EBRD Model Law.
189 Comment to art 25.16 of the EBRD Model Law.
190 Article 25.17 of the EBRD Model Law.
191 Article 25.23 of the EBRD Model Law.
192 Article 26.1 of the EBRD Model Law.

(j) Party autonomy: minimum restrictions

Like the UNCITRAL Guide, there are minimal restrictions on what the parties can include in their security agreement. These limited restrictions allow for increased party autonomy. Nevertheless, there are mandatory provisions that form the foundation of property law which parties cannot exclude from the provisions of a security agreement. Consequently, in respect of the EBRD Model Law, those mandatory provisions also apply. However, the EBRD Model Law remains a flexible instrument despite having to include certain mandatory provisions. The flexibility is particularly evident in the freedom the parties enjoy to define the charged property and the secured debt.[193]

(k) Clear and predictable priority rules

Although having clear and predictable priority rules is not listed as a key concept of the EBRD Model Law,[194] Part 3 of the EBRD Model Law deals with the involvement of third parties (the *erga omnes* enforceability of the charge). The priority of charges in respect of the same property is established by the time at which the charge was created or deemed to have been created (such as the case of future assets which are deemed to be created on registration).[195]

The exceptions to this general priority rule are found in articles 17.2 to 17.8 of the EBRD Model Law. In terms of article 17.2, when a title to a thing or a right has been acquired subject to a charge, the acquirer obtains the asset subject to the charge. Consequently, that first charge enjoys priority over *any* other charge granted by a subsequent acquirer.[196] The second exception relates to the unpaid vendor's charge. The EBRD Model Law does not recognise the concept of 'super-priority' for acquisition finance *per se*.[197] However, the claims under the unpaid vendor's charge take priority over *any* other creditor's claim and therefore is

193 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 81.

194 Clear and predictable priority rules are not included under the list of 'key concepts'. See the discussion of the eight key concepts identified in J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 75-81.

195 Article 17.2 of the EBRD Model Law.

196 The security interest survives the acquisition and has higher priority as it was created first-in-time.

197 See G McCormack 'American private law writ large? The UNCITRAL Secured Transactions Guide' (2011) 60 (3) *Int'l & Comp LQ* 597 at 620 where the author says that there is no such mechanism in the EBRD Model Law. *Contra* see NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 220 where the author agrees that the unpaid vendor's charge holds super-priority status.

functionally equivalent to a 'super-priority' – this despite the unpaid vendor's charge not being registered.[198] There is some debate as to whether the need to protect the vendor who sells goods on credit is more important than notifying third-parties of the existence of a charge or the rights of other secured creditors who went to the trouble of registering their charges.[199] However, super-priority does not extend to the proceeds resulting from the assets secured under the unpaid vendor's charge, and the higher priority only applies for six months after the charge has been created.

Another exception is that a 'possessory charge over negotiable instruments or negotiable documents takes priority over any prior charge'.[200] Further, a security right for money due for services rendered concerning a thing or right, which arises by operation of law takes priority over any prior charge in the same asset.[201] Although it is possible to create a separate priority for an enterprise charge, the priority is not listed as an exception in that additional registration is required for this priority to exist, and the priority of the unpaid vendor's charge will always rank higher than that of the enterprise charge.[202]

Nothing prevents the earlier chargeholders from giving priority to subsequent chargeholders. The argument is that the money received from subsequent lenders may be used to service the earlier loan. Accordingly, this could result in the initial chargeholder wishing to provide special priority to subsequent chargeholders.[203] It is, therefore, possible to alter priority by written agreement between the chargeholders.[204]

(l) Unequal treatment of creditors who provide credit to debtors to acquire movable assets

Arguably, by including the unpaid vendor's charge, the EBRD Model Law creates a framework within which the vendor creditor (the seller) is treated more favourably than the lender creditor.

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198 Article 17.3 of the EBRD Model Law. The concept of 'unpaid vendor's charge is unique to the EBRD Model Law. Further, the other legal instruments under this chapter requires registration and sometimes in the case of inventory, more cumbersome notice requirements for super-priority to exist.

199 See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 219.

200 Article 17.4 of the EBRD Model Law.

201 Article 17.6 of the EBRD Model Law. This is also a unique provision contained in the EBRD Model Law. It may be assumed that this is not mentioned in the other legal instruments discussed in this chapter as these instruments leave it to insolvency law of the legal jurisdiction to deal with the connection between security rights created contractually and those created by operation of law.

202 NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 219-220.

203 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 115.

204 Article 17.8 of the EBRD Model Law.

This was criticised and the potential conflict debated during the early drafting stages of the EBRD Model Law.[205]

Undeniably, the legal position of the lender in respect of lending secured on inventory is inferior to that of a seller in respect of lending secured on inventory. The priority ranking of the seller is higher – albeit for only six months – than any other chargeholder. This higher priority is afforded without any form of publicity. Consequently, the lender needs to conduct proper due diligence to ensure that inventory is not already subject to an unpaid vendor's charge.

4.2.3.3 EBRD Core Principles and fundamental principles contained in the EBRD Model Law

As with the purpose of the key policy objectives under the UNCITRAL Guide, the EBRD Core Principles also provide potential legal reform *goals* as a possible foundation for legal reform. Accordingly, the EBRD Core Principles relate to those policy objectives which the reforming country intends to achieve. The EBRD Core Principles provide the specific ethos of the legal reform which takes place in line with the principles of the EBRD Model Law.[206] Therefore, there is also a connection between the EBRD Core Principles and the fundamental principles associated with the EBRD Model Law. This connection and then links to the research questions of this thesis is illustrated in table 4.1 below.

	EBRD Core Principles achieved through a fundamental principle	**Research question answered through a fundamental principle**
Fundamental principles		
	Principle 1, holding security in collateral must be able to reduce the risk of extending credit, resulting in increased availability of credit on improved terms achieved by all the fundamental principles.	
There must be flexibility in how the secured debt and charged property is defined.	Principle 7 requires that the secured transaction law framework must have a	Research question 3: How comprehensive (or inclusive) should the scope of the secured transactions law framework be?

205 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 82.

206 See Chapter 4 at paragraph 4.2.1 *supra*.

	comprehensive scope of application.	
The security right must comply with the essential qualities of a *property right*.	Principle 2 relates to the quick, *cheap*, and simple creation of a *proprietary* security right without dispossessing the debtor of her asset.	Research question 1: Does a single legal framework result in an effective secured transactions law framework? Research question 2: Should the method of creating a security right be revised?
Most types of charge (excluding the unpaid vendor charge) are registered in a public register.	Core Principle 8, publicity culminates in certainty and predictability of the secured transactions law framework.	Research question 4: What is the best method the achieve third-party effectiveness?
Secured debt and charged property, can be defined in a flexible manner.	Principle 2 relates to the quick, cheap, and *simple* creation of a *proprietary* security right without dispossessing the debtor of her asset.	Research question 2: Should the method of creating a security right be revised?
None of the fundamental principles lists clear priority rules, but the text of the EBRD Model Law contains provisions on priority.	Core Principle 9 requires that clear priority rules must apply.	Research question 5: How predictable and transparent are the current priority rules?
Realisation can take place faster where it is possible that the charged property can be transferred free of the charge.	Core Principle 4 concerns the prompt realisation of the charged property at the market value of the particular asset.	Research question 6: Is the current South African legal framework for the enforcement of creditors' security rights the most efficient option?
Efficient enforcement measures as a result of extrajudicial enforcement measures.	Core Principle 4 concerns the prompt realisation of the charged property at the market value of the particular asset. Core Principle 5 requires that a security right should remain effective after the insolvency or bankruptcy of the debtor.	Research question 6: Is the current South African legal framework for the enforcement of creditors' security rights the most efficient option?
Party autonomy must apply, which entails that there must be minimum restrictions so that the parties can structure the transaction as they deem fit, subject to certain mandatory provisions which must not be removed from the framework.	EBRD Core Principle 10, parties should be able to adapt their security to fit the specific needs of the particular transaction (party autonomy).	Party autonomy was not a research question considered as part of this thesis.

Table 4.1 Interrelationship between the EBRD Core Principles and fundamental principles contained in the EBRD Model Law and the research questions.

4.2.3.4 Concluding remarks: EBRD Model Law

From the above discussion it is clear that the UNCITRAL Guide incorporates some of the EBRD Model Law Core Principles. Although the EBRD Model Law is a less comprehensive document if compared to the UNCITRAL Guide and UNCITRAL Model, the EBRD Model Law is more commercially practical and its concise nature leaves room for interpreting the provisions of the EBRD Model Law using domestic law. Indeed, harmonisation is not an intended purpose of the EBRD Model Law.[207] The unification of secured transactions law may not be achievable as secured transactions cut across property law, insolvency, and contract law – all fields of law falling very much in the exclusive purview of a domestic legislator.[208]

The introduction of a single type of security device – a charge – provides a unified framework, not following a unitary approach but rather a more formal approach. The fact that the functional equivalent to a PMSI, the unpaid vendor's charge, need not be registered to be effective against third parties, follows the approach of some European countries (eg, Germany). Nevertheless, the lack of transparency in respect of the unpaid vendor's charge should not be preferred. The enterprise charge is a novel suggestion and potentially presents a viable alternative to the concept of a 'business bond' (a concept previously known under South African law). Also, including a possessory charge effectively results in a codification of the rules in respect of a traditional possessory pledge.

The OAS Model Law is the next regional instrument considered. It should be noted that the recommendations to the UNCITRAL Guide drew legislative inspiration from the provisions of the OAS Model Law.

4.3 OAS Model Law

4.3.1 Introduction and key features of the OAS Model Law

The OAS produced the Model Inter-American Law on Secured Transactions in 2001 (OAS Model Law)[209] and the accompanying Model Registry Regulations under the Model Inter-

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207 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 68.

208 See J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 68 where the author comments on the possibility of international unification of secured transactions law.

209 Approved by the 6th Inter-American Specialised Conference on Private Law on 8 February 2002. For a general discussion of the legislative process and issues experienced, see AM Garro 'The OAS-sponsored Model Law on Secured Transactions: gestation and implementation' (2010) 15 *Unif L Rev* 391 at 396-399. The OAS does not have a document similar to the EBRD Core Principles for secured transactions law.

American Law on Secured Transactions (OAS Model Registry Regulations) in 2009.[210] The precursor to the development of this model law, designed for use by Latin-American and Caribbean countries, was arguably the project of the National Law Center for Inter-American Free Trade (NLCIFT) to reform the Mexican secured transactions law.[211] The NLCIFT and other Latin-American commercial law experts identified best practices as well as core principles and condensed these into twelve principles. These twelve principles formed the foundation for the first draft of the OAS Model Law.[212] In effect, the OAS Model Law also creates a normative system applicable to secured transactions law[213] – also the approach followed by the UNCITRAL Guide and UNCITRAL Model Law.

The OAS Model Law differs in some respects from the EBRD Model and indeed follows the UCC Article 9 approach to a greater extent.[214] More accurately, the OAS Model Law is an imprint, to a degree, of UCC Article 9. However, the OAS Model Law is a 'simpler and more direct' instrument[215] in which some of the terminology and drafting techniques differ from UCC Article 9 to accommodate civil-law countries in Latin America.[216] The purpose of the OAS Model Law is to create a bridge between countries from common-law and civil-law traditions.[217] This is achieved by the 'normative commonality' that exists between certain Roman law principles forming the basis of both civil-law provisions (the foundation of the law in most Latin-American countries) and specific common-law provisions which formed the basis for the UCC Article 9.[218]

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210 Approved by the 7th Inter-American Specialised Conference on Private Law on 9 October 2009.

211 HL Buxbaum 'Unification of the law governing secured transactions: progress and prospects for reform (2003) 1 *Unif L Rev* 321 at 333; B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 87, 88; B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 262-264; AM Garro 'The creation of a security right and its extension to acquisition financing devices' (2010) 15 *Unif L Rev* 375 at 396-399; and J Barry 'Secured transactions reforms in Mexico: in pursuit of a uniform system' (2012) 34 *Hous J Int'l L* 289 at 297. The authors provide a brief discussion of the history of the development of the OAS Model Law and then comment on the link to the link to the Mexican reform.

212 B Kozolchyk 'Implementation of the OAS Model Law in Latin America: current status' (2011) *Ariz J Int'l & Comp L* 28 at 19.

213 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 268.

214 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 120.

215 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 121. This is another reason why a detailed discussion of UCC Article 9 is not included in this study.

216 U Drobnig 'Unified rules on proprietary security–in the world and in Europe' (2009) 85 *Bol Fac Direito U Coimbra* 667 at 673.

217 HL Buxbaum 'Unification of the law governing secured transactions: progress and prospects for reform (2003) 1 *Unif L Rev* 321 at 334 and the sources at n 64.

218 B Kozolchyk 'Implementation of the OAS Model Law in Latin America: current status' 2011 (28) *Ariz J Int'l & Comp L* 28 at 11.

Harmonisation is not an objective of the OAS Model Law; instead modernisation of existing national laws is preferred.[219] The Model Law subscribes to a uniform system of publicity (functional publicity); priority (based on perfection through functional publicity); and enforcement, which applies equally to all types of consensually created security device.[220] This implies using a functional approach while not necessarily also implementing the unitary approach. In simple terms, the provisions dealing with the structure of the security devices (eg, the traditional pledge) are retained, but new uniform rules applicable to all security devices are added.[221] The scope of the Model Law extends to security interests in movable property (without limiting the type of asset)[222] and to the performance of *any* obligation. The type of property capable of serving as collateral is extended by including future and tangible or intangible movable property as possible collateral.[223] The Model Law further extends to future, determined, or determinable obligations.[224] The aim is to offer adequate protection to third parties while also creating fast and effective enforcement remedies – albeit still subject to some court involvement.[225]

The OAS released a secured transactions book, which combined the OAS Model Law and OAS Model Registry Regulations into a single document. This combined document is referenced in the discussion below.[226] The six key objectives of the OAS Model Law are listed in the introduction to the Model Law (as contained in the combined document) and the general

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219 The preference of the UNCITRAL Guide was harmonisation. See the key policy objective discussed in Chapter 2 paragraph 3.3.2(*k*) *supra*.

220 Introduction to the OAS Model Law and art 1 of the OAS Model Law. See also JM Wilson 'Model registry regulations under the Model Inter-American Law on Secured Transactions' (2010) 15 *Unif L Rev* 515 at 518 and B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 267, 269.

221 An example includes additional obligations placed on the creditor in possession of the collateral (art 33 of the OAS Model Law). Further, see B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 267.

222 However, the Model Law allows the adopting state to exclude a security interest in a type of asset where a special type of law or markets govern this type of asset (eg, investment securities or mobile equipment intended under the Cape Town Convention). See B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 265.

223 Introduction to the OAS Model Law and art 2 of the OAS Model Law where the scope extends to any obligation of any nature, be it present or future, determined or determinable. See also B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 266.

224 Article 1 of the OAS Model Law.

225 Introduction to the OAS Model Law at 15 of the OAS Secured Transactions Book available at http://www.oas.org/en/sla/dil/docs/secured_transactions_book_model_law.pdf (date of access: 10 October 2018).

226 OAS Secured Transactions Book available at http://www.oas.org/en/sla/dil/docs/secured_transactions_book_model_law.pdf (date of access: 10 October 2018).

theme of the objectives closely resembles the key policy objectives of the UNCITRAL instruments.

4.3.2 Key policy objectives of the OAS Model Law

The introduction to the OAS Model Law contains a list of its main objectives, followed by the article numbers in the Model Law, which are aimed at achieving a specific key policy objective.[227] The first objective is to promote access to credit by extending the scope of property that may be taken as collateral.[228] This key policy objective corresponds to two objectives of the UNCITRAL instruments: (1) recommendation 1(*a*) which aims to promote lost-cost credit as a result of secured credit being more readily available; and (2) recommendation 1(*b*) that a debtor must be able to use the full inherent value locked in her asset. The next key policy objective is to have a simple process for creating the security interest, so resulting in a reduction in the cost of credit.[229] The OAS Model Law also aims to promote transparency by establishing clear requirements for publicity[230] and standardising the documentary and registration aspects of security.[231] It also aims to create certainty as to the priority of security interests by establishing 'foreseeable and detailed' criteria to establish the order of priority. This objective links to recommendation 1(*g*) of the UNCITRAL Guide[232] The final objective is to enhance the efficiency of enforcement by allowing speedy enforcement while also balancing the protection of the debtor against unnecessary loss, and providing reasonable assurances to protect the debtor.[233] The OAS Model Law key policy objectives correspond closely to UNCITRAL instruments' key policy objectives.[234] But, other than the UNCITRAL Guide, the OAS Model Law does not have key objectives on party autonomy or harmonisation.

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227 The introduction is not included in all versions of the OAS Model Law. This study used the combined document 'Model Inter-American Law on Secured Transactions: Model Registry Regulations' released by the Department of International Law: Secretariat for Legal Affairs. This document incorporates the OAS Model Law.

228 This finds application through art 4 of the OAS Model Law.

229 This objective is shared with the UNCITRAL instruments, See Chapter 3 paragraph 3.3.2(c) *supra* for a discussion of recommendation 1(*c*)). The objective is applied in arts 5-9 of the OAS Model Law.

230 This finds application through arts 10-34 of the OAS Model Law.

231 This finds application through arts 35-46 of the OAS Model Law. The UNCITRAL Guide contains a similar key objective (recommendation 1(*f*)).

232 This finds application through arts 47-53 of the OAS Model Law.

233 This finds application through arts 54-67 of the OAS Model Law. The UNCITRAL Guide's objective is similar in theme but is more general as it refers to the efficient enforcement of the secured creditor's rights (recommendation 1(*h*)).

234 SV Bazinas 'The OAS and the UNCITRAL Model Laws on Secured Transactions compared' (2017) 22 *Unif L Rev* 914 at 916.

A country wishing to base its reforms on the OAS Model Law, need not adopt all the Model Law provisions. Reforming countries may use and adapt the provisions to suit the peculiar circumstances of their country.[235] The fundamental principles incorporated in the provisions of the OAS Model Law aim to achieve the key policy objectives discussed *supra* are discussed further in what follows. Other than the UNCITRAL Guide, the fundamental principles are not listed in the OAS Model Law. Consequently, the fundamental principles guiding the OAS Model Law are identified by analysing its provisions and relying on the structure advanced by the UNCITRAL Guide and UNCITRAL Model Law, and to some extent, by EBRD Model Law.

4.3.3 Fundamental principles (policies)

4.3.3.1 A uniform system, not a full unitary approach

Arguably, it is simpler to follow a unitary approach when reforming a legal framework, but most Latin-American member countries with entrenched civil-law traditions, did not support a unitary approach.[236] The compromise was to introduce a uniform system in respect of registration of any right which qualifies as a security interest, together with a priority system and enforcement mechanisms that apply to all security interests, irrespective of the type of security device used.[237] Scholars refer to a 'unitary system', but to ensure a clear distinction between a fully unitary system (as proposed by the UNCITRAL framework), this study refers to a 'uniform system of legal rules'. Technically, it may indeed be 'doctrinally suspect' to classify the OAS Model Law approach as 'unitary' as intended under the UNCITRAL framework and the UCC Article 9. The OAS Model Law approach is more correctly described as a uniform application of legal rules, or something 'less than a *universal* unitary system'. It

235 Introduction to the OAS Model Law at 15 of the OAS Secured Transactions Book available at http://www.oas.org/en/sla/dil/docs/secured_transactions_book_model_law.pdf (date of access: 10 October 2018).

236 B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 90 and B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 266-267.

237 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* at (2011) at 123. See also B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 90 and B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 266.

is argued that what is referred to as a 'non-unitary approach' which applies to acquisition security rights under the UNCITRAL Guide, is founded on the OAS Model Law approach.[238]

In terms of article 1 of the OAS Model Law, the adopting state must create a 'unitary and uniform registration system' which should apply to all property security devices that exist in its domestic framework.[239] The introduction of a unitary registration system potentially has two important consequences. It means that (1) a non-possessory security interest, (2) a possessory security interest, and (3) a right under a title-based security device, are still created using different methods (thus different legal rules apply in respect of creation). Also, a possessory security interest either must be registered before it becomes effective against a third party, or the registration will only influence the priority ranking of this possessory security interest. Therefore, the exact moment of creation and third-party effectiveness of a possessory security interest and a non-possessory security interest needs to be clarified.

4.3.3.2 Comprehensive scope: assets, obligations, secured transactions, and parties

All the other secured transaction law frameworks discussed in Chapters 3 and 4 of this study recommended a comprehensive scope as a fundamental principle. Accordingly, this is also a fundamental principle of the OAS Model Law. The scope of the framework is comprehensive, both in respect of type of movable property, and as regards which type of obligation may be secured. Any party competent in law must be able to be party to a secured transaction.[240] Essentially, the Model Law applies to contractually-created security interests in any type of movable asset (unless specifically excluded for a valid reason) that can secure the fulfilment of almost any type of contractual obligation.

(a) Assets

Potentially, a security interest can be created in any movable property (corporeal or incorporeal) that has an economic value. This movable property includes either: (1) a specific item; (2) a specific or generic category of movable property (eg, an economic entity); or (3) an

238 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* at (2011) at 146.

239 Presumably this does not relate to a possessory security device.

240 SV Bazinas 'The OAS and the UNCITRAL Model Laws on Secured Transactions compared' (2017) 22 *Unif L Rev* 914 at 916. The UNCITRAL instruments share this fundamental principle. See the discussion in Chapter 3 paragraph 3.3.3.1 *supra*.

'all-asset security' which extends to the debtor's future and present movable property.[241] A country has the option to exclude certain types of collateral from the scope of its secured credit regime,[242] for example, ships or aircraft. As under the EBRD Model Law, the secured obligation and collateral may be described either specifically or generically.[243]

The types of movable property specifically listed as included under the Model Law's scope, are: (1) receivables or other kinds of intellectual property; and (2) specific or generic *categories* of movable property, including but not limited to attributable movable property.[244] 'Receivables' relate to the debtor's right (which right can be contractual or non-contractual) to either claim or receive a monetary sum, at present or at a future date.[245] 'Receivables' under the OAS Model Law includes both the outright sale of the receivables (which need only comply with the publicity requirement of the OAS Model Law) and receivables used to secure a loan.[246] As under the UNCITRAL framework, both contractual and non-contractual receivables are included, and the security interest can extend to future receivables as well. The OAS Model Law does not exclude specific types of payment, as is the case under the UNCITRAL instruments. However, the reference to 'payment of any monetary sum' amounts to essentially the same type of payment remaining under the UNCITRAL framework after excluding the listed type of payments from the meaning of 'receivables'.[247]

The concept of 'attributable movable property' in the OAS Model Law is the functional equivalent of 'proceeds' and potentially also 'a mass and product', included under other legal frameworks.[248] Attributable movable property is property identifiable as originating from the original encumbered property, including the fruits or property resulting from the 'sale, substitution or transformation' of the original collateral.[249] Consequently, this definition includes 'proceeds', and, as 'transformation' is included, extends to manufactured assets (a

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241 Articles 2 and 3(V) of the OAS Model Law. See also B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 264.

242 Article 1 of the OAS Model Law. For example, investment securities require very specific regulation, or high-value assets regulated under the Cape Town Convention can be excluded from the scope. See B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 89; B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 265; and G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 122.

243 Article 7(IV) and (VI).

244 Article 3(V) of the OAS Model Law.

245 Article 3(X) of the OAS Model Law.

246 The UNCITRAL framework also extends to both types of receivable. See Chapter 3 paragraph 3.3.3.1(*b*) *supra*.

247 See Chapter 3 paragraph 3.3.3.1(*a*) *supra*.

248 See Chapter 3 aragraphs 3.3.3.1(*c*) and 3.3.3.4 *supra*.

249 Article 3(VI) of the OAS Model Law.

product) and commingled goods (a mass). Unlike other legal instruments, the Model Law does not include the requirement that the attributable property must be 'identifiable and traceable'. The only requirement is that it must be possible to establish that the attributable property was derived from the original encumbered property. The drafters of the Model Law specifically excluded this requirement in respect of proceeds, as it was casuistic and resembled 'common-law type laws',[250] which may be harder to follow for civil-law traditions. The security interest can only also *automatically* extends to the attributable movable property if the registration form used to register the security interest,[251] states this as a consequence of registration.[252] Also, unlike the approach under the UNCITRAL Model Law, there is no reference to the security interest either extending to 'proceeds from proceeds' or proceeds received by a transferee (a person who acquired an asset subject to an existing security interest). The question in this instance is whether the phrase 'identifiable as originating' from the original encumbered property, is wide enough to include these cases.

A security interest may also cover future property, but only from the moment when the secured debtor acquires the rights in respect of the future property.[253] The OAS Model Law also allows for the secured debtor to obtain a line of credit secured over a 'fluctuating fund of present and future collateral', thus revolving assets like inventory are included within its ambit.[254] This is possible because the definition of movable property includes 'specific or general categories of movable property' and the obligation which may be secured, includes 'present or future obligations'.[255] Also, the definition of inventory presupposes the fluctuating nature of this type of asset when it refers to 'movable property *held by a person for sale or lease* in the ordinary course of that person's business operations' (emphasis added). So, floating liens and future advances, too, are included.[256] The priority is fixed on the date on

250 B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 95.

251 The registration form refers to form that contains specific information and which is used by the registry to register a security interest in the movable property. See art 3(VII) of the OAS Model Law.

252 Article 11 of the OAS Model Law.

253 Article 6 of the OAS Model Law.

254 B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 96.

255 Articles 2 and 3(V) of the OAS Model Law.

256 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 271.

which the registration form is registered. Further, a maximum amount must be included in the registration form, and this also applies to floating securities.[257]

It is possible for the security interest to extend to movable property affixed to immovable property. However, there must be publicity via special registration in the *immovable* property registry *before* the movable property is attached to the immovable property. However, a security interest only extends to such an affixed movable where the object retains its identity as *movable property*.[258] This appears an unlikely outcome as the movable property becomes immovable in most domestic law when it is fixed to immovable property (unless, of course, the domestic law governing fixtures is amended). Therefore, the OAS Model Law does not follow the approach of the UNCITRAL Guide but rather retains the legal tradition that the movable property becomes 'immovable property' on attachment.

(b) Obligations and secured transactions

The OAS Model Law also favours recognising 'the substance over the form' of the secured transaction. Consequently, the Model Law is not overly prescriptive on the form of the secured transaction which secures a specific obligation. As a result, a secured transaction should be able to secure most types of obligation. The OAS Model Law recommends that secured transactions should be able to secure any obligation, including present or future and determined or determinable obligations.[259] More specifically, the security interest should secure the fulfilment of

> 'one or more present or future obligations, regardless of the form of the transaction and *regardless of whether ownership* of the property is held by the secured creditor or secured debtor' (emphasis added).[260]

A uniform system accommodates different types of security device under a single and comprehensive framework. Accordingly, title-based devices should be treated the same as traditional security devices (like mortgages and pledges). According to McCormack, there is

257 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 271. Parties must carefully consider the amount included in the registration form in line with the required commercial need they will have in the future.
258 Article 52(IV) of the OAS Model Law.
259 Article 1 of the OAS Model Law.
260 Article 2 of the OAS Model Law.

some uncertainty as to the classification of the *quasi*-security interests which derive from a retention-of-title or a financial lease as part of the OAS Model Law framework. The reason for this is the phrase in article 2, 'regardless of whether ownership of the property is held by the secured creditor or secured debtor' (in the above).[261] UCC Article 9 contains similar wording, but this is followed by an itemised list of rights specifically included in the concept of a security interest. The OAS Model Law only mentions one type of title-based device – factoring (assignment of receivables) – and mentions neither retention-of-title nor leases.[262] However, it should be borne in mind that the OAS Model Law does not follow a unitary approach, but only a unitary system for registration purposes. There is, therefore, no need for reclassification before these types of right can be registered. Also, including an itemised list arguably would have reduced the flexibility of the Model Law with regard to the scope of obligations to which it applies and also its ability to retain the traditional labels of security devices. Consequently, the OAS Model does also cater for acquisition financing, and in this regard uses the concept of 'acquisition security interest',[263] diverging from the UCC Article 9 concept of PMSI.

Under the OAS Model Law, 'secured obligations may be present or future, determined or determinable'.[264] Accordingly, the Model Law extends to future advances and floating obligations where the priority of the security interest links back to the date of registration of the initial security interest.[265] The only limitation is that the parties must insert, in both the security contract[266] and the registration form, the maximum amount which will be secured by the security interest. [267] There is no limit to the amount which can be declared so the parties must ensure that the amount is high enough to accommodate future obligations. Also, an acquisition security right mitigates the potential restrictions a floating security device may have on the debtor.[268] In simple terms, where the debtor grants a floating lien, this means that the secured creditor has security in all current and future assets of the debtor. The revolving line of credit creates a monopoly where the debtor will not be able to secure further finance from

261 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 124.
262 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 124.
263 The UNCITRAL Guide most probably followed the OAS Model Law in this regard.
264 Article 1 of the OAS Model Law. This differs from civil law traditions which require the secured creditor to provide the precise amount of the secured debt. See B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 96.
265 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 271.
266 Article 7(III) of the OAS Model Law.
267 Article 38(III) of the OAS Model Law. This requirement is the same for South African covering bonds. See Chapter 2 paragraph 2.3.3.3(*a*) *supra*.
268 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 272.

another creditor unless the new creditor is an acquisition creditor who acquires super-priority above the previous secured creditor who holds a floating security device. The acquisition security interest in terms of the OAS Model Law is discussed further *infra*.[269]

(c) Parties

Even though the OAS Model Law applies to any person able to provide a security interest over movable property, it specifically excludes 'consumers' as secured debtors. The principle of universality also exists with regard to who may be a secured creditor or a secured debtor.[270] A secured debtor includes a 'person, whether the principal debtor or a third party, who creates a security interest over movable property' according to the provisions of the Model Law.[271] The definition of a secured creditor is just as general and includes a 'person in whose favour a security interest is created, possessory or non-possessory' which interest is either for the benefit of the secured creditor of other persons.[272]

4.3.3.3 Creation must be simple and distinct from third-party effectiveness

The OAS Model Law distinguishes between the moment at which the security interest is created, and the separate event when a non-possessory security interest becomes effective against third parties.[273] This clear separation corresponds to the approach of UNCITRAL instruments. Further, the OAS Model Law also contains asset-specific creation rules (eg, for a security interest in receivables, bank accounts, and negotiable instruments).

A non-possessory security interest is created when the secured debtor and secured creditor enter into a written security contract.[274] However, a possessory security interest is created when 'the secured debtor delivers possession or control of the collateral to the secured creditor'.[275] Article 8 does not use the phrase 'creation' but notes that a possessory security

269 See paragraph 4.3.3.7 *infra*.
270 The OAS Model Law is the only instrument that refers to the debtor as 'secured', even though the debtor cannot be regarded as secured. See SV Bazinas 'The OAS and the UNCITRAL Model Laws on Secured Transactions compared' (2017) 22 *Unif L Rev* 914 at 917.
271 Article 3(II) of the OAS Model Law.
272 Article 3(III) of the OAS Model Law.
273 A possessory security interest is not created through a security contract but requires transfer of control or possession to the secured creditor. See art 6 of the OAS Model Law.
274 Article 5 of the OAS Model Law.
275 Article 8 of the OAS Model Law. 'Control' under the UNCITRAL instruments concerned incorporeal movable property, which would probably be the same approach under the OAS Model Law.

interest 'takes effect'. The meaning of 'takes effect' may either denote that the security interest only takes effect between the creditor and debtor (thus creation) or that the security interest takes effect against third parties as well. Article 8 falls under title III of the OAS Model Law dealing with creation. Nevertheless, what complicates the matter is that a uniform registration system implies that all types of security interest need to be registered, but article 10 also allows publicity of security interest 'by delivery of possession or control'. This ambiguity regarding when a possessory security interest is created needs to be interpreted against the aim of the OAS Model Law to retain traditional security devices, including the traditional possessory pledge. A possessory security interest can only be created through the transfer of possession or control. The submission is that the possessory security interest under the OAS Model Law is created and becomes effective against third parties simultaneously with the transfer of possession or control. It makes no sense to require that a possessory security interest must be registered for no apparent reason –not even to establish priority ranking. Also, the provisions of article 33 place additional obligations on the creditor in possession of the collateral. The purpose of the additional obligations is to place all debtors on an equal legal footing as far as possible. In the case of a possessory security interest, the secured debtor does not have possession of the collateral so the secured creditor must use reasonable care to preserve the value of the collateral and the rights stemming from the collateral.

The creation of the security interest does not depend on the existence of an accessory principal loan agreement.[276] Under the Model Law, the security interest is, therefore, independent of the principal loan.[277] In simple terms, it is possible that the security interest can be created without the need for the prior execution of a principal loan agreement.[278] The effect is that a non-possessory security interest will become effective *inter partes* from the moment of execution of the security contract, unless: (1) the parties have agreed otherwise; or (2) the security interest relates to a future or after-acquired property, where the debtor has not acquired the rights in this property.[279]

276 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 269.

277 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 269.

278 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 269.

279 Article 6 of the OAS Model Law.

As mentioned above, the security contract which creates a non-possessory security interest must be in writing, unless the parties have agreed otherwise.[280] The meaning of 'in writing' includes any method that leaves a lasting record of the shared consent of the intention of the parties to create the security interest. According to article 7 of the Model Law, the security contract must, at least, contain the following: (1) the date of executing the security contract;[281] (2) information which makes it possible to identify the secured debtor and secured creditor; (3) the written or electronic signature of the secured debtor *only*;[282] either a generic or specific asset description;[283] (4) an express declaration that the movable property (mentioned in the security agreement) will be used as collateral to secure an obligation; and (5) 'a generic or specific description of the secured obligations'.[284] These requirements are relatively simple and so comply with the objective of simplicity when it comes to the creation of a security interest.[285]

The OAS Model Law departs from the strict application of the specificity principle and allows the parties to describe the collateral generically, both in the security contract and in the subsequent registration form.[286] This flexibility in respect of describing the movable property and the secured obligations makes it possible for the Model Law to extend to future (or after-acquired) movable property. Nevertheless, the security interest will only exist from the moment that the debtor or grantor *acquired* the right to encumber the property.[287] However, the secured creditor can file a notice in respect of future property which would secure a priority above competing secured creditors with retrospective effect. Similar to the approach under the UNCITRAL instruments, the date used to determine the priority ranking could pre-date the date from which the security right existed. The OAS Model Law provisions regarding when the security interest becomes effective against third parties are discussed next.

4.3.3.4 Publicity: registration and delivery of possession or control

280 Article 6 of the OAS Model Law. Under EBRD Model Law the distinction was made between in writing or reduced to writing, allowing the opportunity for oral agreements.
281 Especially as this is regarded as the creation date of the security interest.
282 This is the only instrument discussed in this chapter which requires a signature from the secured debtor.
283 The UNCITRAL Guide requirements are more specific as the encumbered asset must be 'identifiable'. However, the EBRD also only require a generic or specific description depending on which charge is used.
284 Article 7 of the OAS Model Law.
285 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 269.
286 Articles 2, 7(IV) and 38(IV) of the OAS Model Law.
287 Article 6 of the OAS Model Law.

(a) General rules

Title III of the OAS Model Law deals with the general rules on 'publicity', while Title IV deals with 'Registry and Related Matters'. Also, the OAS Registry Model Regulations contain general rules on the operation of the registry. According to article 10, the security interest will become enforceable against all third parties once it has been publicised. The Model Law includes different methods of publicity: (1) non-possessory security interests must be registered;[288] (2) possessory security interests require either delivery of possession of the collateral (in respect of corporeal movable property),[289] or possession or control of the collateral (in respect of incorporeal movable property) to either the secured creditor or a third person on behalf of the secured creditor.[290] Further, the OAS Model Law acknowledges that certain types of collateral, like investment securities, are transferred through an electronic registry. Accordingly, the rules of that electronic registry will determine the moment when the transfer of control in respect of this specific type of collateral takes place.[291]

Where a security interest is effective against third parties, it may also cover attributable movable property. However, this is only possible if the registration form in respect of the main movable property allows for this eventuality.[292]

As under the UNCITRAL framework, there are instances where the third-party effectiveness of the security interest will not persist. The most common exception concerns purchases made by buyers in the ordinary course of business.[293] A buyer who purchases goods that are sold to her in the ordinary course of business, takes the movable property free from any security interests, regardless of whether or not the security interest was publicised, but subject to compliance with the following two conditions (which are part of the definition of a buyer in the ordinary course of business).[294] Firstly, the buyer must give value in return for the acquired property.[295] Further, the seller must be in the business of selling the type of goods that

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288 The most common method under the Model Law, as is the case with the other instruments discussed in this study, is registration. See B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 272.

289 For example, delivery of the letter of credit in which a security interest exists (art 23); delivery of an instrument or document, of which the title is negotiable either by endorsement and delivery; or delivery alone (art 27).

290 Article 30 of the OAS Model Law. This relates to a security agent or the concept of 'warehousing'. Provisions regarding a security agent were also added in the 2010 amendments to the OHADA UAS.

291 Article 28 of the OAS Model Law.

292 Article 11 of the OAS Model Law.

293 Article 49 of the OAS Model Law relates to the ordinary-course-of-business exception.

294 Article 49 of the OAS Model Law.

295 Article 3(IV) of the OAS Model Law defines a buyer in the ordinary course of business.

the buyer bought.[296] This exception is based on a clear policy consideration. A consumer would be deterred from buying goods if there is a fear of dispossession by a creditor of the seller, which ultimately might reduce sales of certain goods and, in turn, could have a broader economic impact.[297] The possible prejudice to the creditor is balanced by the fact that she still has a security interest in the cash proceeds resulting from the collateral. Also, where the buyer acquires the asset fraudulently, the security interest follows the collateral.[298]

(b) Registration: notice filing

Non-possessory security interests are publicised through registration and are effective against third parties as soon as registration takes place.[299] Publicity for a non-possessory security interest takes place through the registration of either a document or an electronic message, thus through notice-filing, not transaction-filing. The purpose of this notice is to alert third parties to the *potential* that a security agreement exists or could come into existence,[300] which is the same purpose served by notice-filing under the UNCITRAL framework.

According to the OAS Model Registry Regulations, the staff of the registry has no obligation to verify the accuracy or legal sufficiency of the filed information,[301] which is a typical characteristic of a notice-filing framework. The details to be included with registration are: the names and addresses of the secured debtor (or where there is more than one, all of them) and creditor; the maximum amount secured by that security interest; and the description of the collateral, which can be either general or specific.[302] The security interest becomes effective against third parties as soon as it is registered, unless, of course, the interest secures a future obligation.[303] Further, a single registration of a security interest in respect of movable property in the form of inventory can extend to 'present and future property, and its attributable

296 Article 3(IV) of the OAS Model Law defines a buyer in the ordinary course of business.
297 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 255.
298 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 255.
299 Article 10 of the OAS Model Law refers to publicity through registration or by delivery of possession of the collateral.
300 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 251.
301 Comment to art 5 of the OAS Model Registry Regulations.
302 Article 38 of the OAS Model Law.
303 Article 35 of the OAS Model Law. The Model Law does not provide an explanation of what is meant by 'registration'. Under the UNCITRAL Guide, the discussion on the recommendations clarifies that this is the moment the entry is available on the public registry.

movable property, or any part thereof'.[304] The registration is valid for five years and is renewable for a further three years.[305]

Article 14 of the OAS Model Registry Regulations sets out how the collateral must be described in the registry. For property described in generic terms, the description can refer to *all* of the debtor's property of the same kind in which the debtor either: (1) has a right at the date of registration; or (2) will acquire a right during the registration period (an 'all-asset' security). In general, the following information is standard for all registrations: the maximum amount that is secured by the security interest; whether the security will also apply to attributable property; whether this is an acquisition security right; and when the registration terminates.[306]

Article 14 OAS Model Registry Regulations contains different drafting options for describing specific types of property determined with reference to the nature of that movable property.[307] Article 14 (III) applies to 'serial-numbered property not held for sale or lease in the ordinary course of the secured debtor's business'. The serial-numbered property, excluding an aircraft,[308] is identified by using the last ten alphanumeric characters of the serial number along with manufacturer's name displayed on the property. In the case of a motor vehicle, the model year of the vehicle must also be displayed. Article 14 (IV) applies to serial-numbered property in the form of a permit or licence where that permit or licence is recorded in the records of an issuing authority. Under this option, the unique number displayed on the licence or permit, as well as the name of the issuer, must be included in the registration. Article 14 (V) relates to fixtures and crops.[309] In the case of a fixture to immovable property, the description of the real estate (immovable property) must be included. In the case of crops, the description of the immovable property on which the crops will be planted or are growing must be included as part of the registration.[310]

304 Article 31 of the OAS Model Law.
305 Article 39 of the OAS Model Law.
306 Article 14 (IV) of the OAS Model Law Registry Regulations.
307 Article 14 (III) and (IV) of the OAS Model Law Registry Regulations is optional. The description of fixtures or crops is compulsory in terms of art 14(V) of the OAS Model Law Registry Regulations.
308 For aircraft, the serial number as required by the law implementing the Convention of International Aviation, 1944, Chicago. See art 14(III) of the OAS Model Law Registry Regulations.
309 If the traditional rules of accession are followed 'crops' become immovable property. However, under the OAS Model Law, these crops are now identifiable and attributable property.
310 Other instruments also use a category description of assets (eg, the Cape Town Convention and the Australian PPSA).

(c) Delivery of possession or control

According to article 8, a possessory security interest *takes effect* when the secured debtor delivers possession or control[311] to the secured creditor or the designated third party. However, article 8 is included under the heading of the OAS Model Law dealing with 'creation'. According to article 10, which deals with when the security interest takes effect against third parties, a security interest can also be publicised 'by delivery of possession or control of the collateral' to the secured creditor or her representative. It is not possible to publicise the security interest in a letter of credit. A security interest in a letter of credit can only be publicised by delivery of the letter of credit to the secured creditor.[312]

(d) Approach to receivables

The assignment of receivables is incorporated as part of the proposed reforms. Consequently, the OAS Model Law includes provisions specific to receivables in an attempt to follow the provisions of the United Nations Convention of Assignment of Receivables in International Trade.[313] 'Receivables', which can technically also amount to 'attributable movable property' as proceeds resulting from the sale of inventory, are dealt with separately in articles 13 to 20. A security interest in a receivable owed to the secured debtor must be publicised through registration before it becomes effective against third parties.[314] The security interest does not influence the legal standing between the secured debtor and the account debtor. Nevertheless, where a secured creditor gives notice to the account debtor using any generally accepted means of communication of the security interest in the receivable, the account debtor must make payment directly to the secured creditor.[315] However, where the account debtor received more than one notice from different secured creditors in respect of the same receivable, the account debtor need only honour the first notice received.[316]

311 It is possible for a third party to have possession of the encumbered property on behalf of the secured creditor if the secured debtor has consented (art 30 of the OAS Model Law). This article allows for 'warehousing'. The third party holding the property has an obligation to disclose to any enquiring party whether they received a notice that there is a security interest covering the property in their possession. The possession under the Model Law must be actual possession as constructive possession within the context of possessory security interest is not allowed.

312 Article 23 of the OAS Model Law.

313 B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 101.

314 Article 14 of the OAS Model Law.

315 Article 17 of the OAS Model Law.

316 Article 18 of the OAS Model Law.

4.3.3.5 Priority must be clear and predictable

Also under the OAS Model Law, the general rule is that priority is established by relying on a first-in-time, first-in-right approach (*prior tempore potior iure*).[317] Determining creditor priority is linked to when publicity of the security interest was confirmed (through possession, control, or registration).[318] Nevertheless, as under the UNCITRAL and EBRD frameworks, there are exceptions to the general priority rule. The first exception extends to super-priority in the case of acquisition finance.[319] A further exception involves the subordination of security interest resulting from a written agreement between the secured creditors.[320] The discussion *infra* relates to the general rules of priority and the provisions of the exceptions. This is followed by confirming whether priority continues after *accession* and into a mass or a product.

The Model Law affords the acquisition secured creditor with a super-priority, subject to compliance with the advance notice required in article 40.[321] The acquisition secured creditor must file a notice *before* the debtor obtains possession of the collateral to secure a super-priority.[322] In addition to filing the notice, (1) the initial registration form must indicate the special nature of the acquisition security interest, and (2) other secured creditors, who have already perfected their security interests over the property of the *same* kind, must receive notice of the intended acquisition security interest. Similar to most legal instruments discussed in this thesis, the super-priority only extends to *cash* proceeds resulting from the sale of the acquisition-type asset.[323]

Movable property attached to an immovable property can potentially be subject to a security interest. However, for that security interest to enjoy priority over a security interest in the immovable property, the security interest over the movables should be registered in the *immovable* property registry *before* being affixed to the land[324] – as is also required under the UNCITRAL Model Law. This priority is also subject to the attached movable property not having lost its identity as movable property when it was affixed. The OAS Model Law makes

317 Article 48 of the OAS Model Law. See also, B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 121.
318 Article 48 of the OAS Model Law.
319 Article 51 of the OAS Model Law relates to this exception in respect of an acquisition security interest.
320 Article 50 of the OAS Model Law.
321 Article 51 of the OAS Model Law.
322 The Model Law does not specify that this requirement applies only in case of inventory similar to Alternative A to recommendation 180 of the UNCITRAL Guide.
323 Article 51 of the OAS Model Law.
324 Article 52(IV) of the OAS Model Law.

no direct reference to the priority in respect of a mass or a product, but it can be regarded as included as attributable property.

4.3.3.6 Enforcement: extrajudicial and judicial proceedings

(a) General enforcement provisions

Enforcement forms the topic of title VI of the OAS Model Law. As is the case under the EBRD Model Law and the UNCITRAL frameworks (discussed in Chapter 3), extrajudicial enforcement is also possible under the OAS Model Law although the Model Law retains the terminology 'summary judicial and quasi-judicial procedures'.[325] This means that judicial enforcement proceedings remain, albeit in an expedited form, where a judicial officer is still involved in some stages of the enforcement process. Under the OAS Model Law, the secured creditor must make a formal request for payment before a notary public, public broker, or a judicial officer before commencing enforcement action.[326] It is assumed that this formal requisition would take place prior to the registration of the enforcement form at the Registry but the OAS Model Law is not prescriptive in this respect.

The secured creditor must first register an enforcement form in the Registry and then deliver a copy of the form to the secured debtor.[327] The enforcement form must include the following: (1) a short report of the secured debtor's default; (2) a description of the collateral; (3) an amount that includes a reasonable estimate of the creditor's enforcement expenses and what it would take to satisfy the secured obligation; (4) a statement of the rights of the person who receives the notice; and (5) a declaration of the nature of the enforcement remedies the secured creditor plans to exercise.[328] Thus, detailed information regarding enforcement is required, and even though this places a cumbersome duty on the secured creditor, such detail is needed to balance out any potential prejudice that might be suffered as a result of using expedited judicial enforcement.

(b) Repossession or control

325 B Kozolchyk & DB Furnish 'The OAS Model Law on Secured Transactions: a comparative analysis' (2006) 12 *Sw J of L & Trade Am* 235 at 274.

326 Article 55 of the OAS Model Law. See also B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 124.

327 Article 54 of the OAS Model Law and art 16 of the OAS Model Law Registry.

328 Article 54 of the OAS Model Law.

The OAS Model Law does not allow extrajudicial repossession. Repossession can only take place after obtaining an attachment order using an expedited judicial process. After receipt of a copy of the enforcement form, the debtor has three days to provide a defence against the enforcement claim to a judge or the notary involved (the judicial official who heard the requisition for payment). In terms of article 56, either full payment of the entire amount or the amount in arrears at that time, including reasonable enforcement expenses in both instances, remains the only defence a debtor can raise against the creditor's claim.[329] Where the debtor fails to provide this defence (by providing proof of payment), the creditor can approach *any* judge to issue an order for repossession in case of a non-possessory security interest in respect of corporeal movable property, without giving the debtor a further opportunity to be heard.[330] If the debtor wishes to raise a defence after the three day period has elapsed, this must be done through a separate judicial process[331] but the secured creditor may still take possession of the collateral.[332]

Where the secured creditor does not have possession of the collateral, repossession can only take place subject to a court order. In respect of a possessory security right or a non-possessory security interest in the incorporeal property, the secured creditor essentially already has possession, removing the need for an attachment order. Accordingly, the secured creditor may dispose of this collateral as soon as the three days after delivery of the enforcement form to the debtor have lapsed.[333]

(c) Disposition of the collateral

The OAS Model allows extrajudicial disposition (disposition without further court involvement). The collateral (in the possession of the secured creditor) may be sold or appropriated as payment for the debt.[334] The collateral may be sold privately or taken as payment of the debt, subject to the value of the property being 'appraised by a single qualified appraiser designated by the secured creditor'.[335] If sold at public auction, the sale must be

329 Effectively, reinstatement takes place where the outstanding amounts and reasonable cost is paid (art 58 (II) of the OAS Model Law). Practically, it could mean that the cost has to be agreed between the parties or properly taxed.
330 Article 57 of the OAS Model Law. The Model Law specifically use the term 'repossession' even though the secured creditor may not have had possession before.
331 Article 57 of the OAS Model Law.
332 Article 57 of the OAS Model Law.
333 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 127.
334 Article 59 (IV) of the OAS Model Law.
335 Article 59 (IV) of the OAS Model Law.

announced in two major publications at least five days before the auction. Also, at the public auction, the collateral will be sold without reserve to the highest bidder.[336] Acquiring an appraisal of the price of the collateral is a novel contribution by the OAS Model Law. Where the secured creditor either sells the collateral at a private sale, or takes over the collateral, the correlation between the value of the collateral and the purchase price needs to be independently determined to avoid any potential prejudice to a potentially unsuspecting debtor. Therefore, the secured creditor must appoint a 'single qualified appraiser' to make an appraisal of the purchase price.[337]

Where the collateral consists of certain types of movable property, the secured creditor will acquire specific rights in respect of those assets. Collateral in the form of receivables allows the secured creditor to 'enforce the receivables against the person obligated on the receivable' (meaning that the creditor can collect the payment directly from that debtor).[338] Further, as regards collateral in the form of stocks, bonds, or similar property, the secured creditor may exercise all the rights the secured debtor had in respect of that property, on behalf of the secured debtor.[339] These rights include redemption rights, rights to draw, voting rights, and even the right to collect dividends or receive other revenue derived from the collateral.[340]

The enforcement process continues despite ongoing appeals against any judicial decisions.[341] This provision takes cognisance of delays resulting from the debtor instituting appeal and defence motions or actions, which arguably result in prolonged enforcement actions not only in Latin-American countries,[342] but elsewhere as well. The debtor only retains the right to claim damages against a creditor who has abused its enforcement rights. This is problematic for the debtor but makes sense because the only defence a debtor can raise is full payment of the outstanding debt, and because any other defence will have no relevance for a judicial decision.

The principle of party autonomy forms part of the enforcement proceedings.[343] The parties are free at any time before or during the enforcement proceedings, to agree on either

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336 Article 59 (IV) of the OAS Model Law. This provision clearly favours the creditor as the creditor is allowed to sell the property at a lower price than it is worth and still collect the balance from the secured debtor.
337 Article 59 (IV) of the OAS Model Law.
338 Article 59(II) of the OAS Model Law.
339 Article 59(III) of the OAS Model Law.
340 Article 59(III) of the OAS Model Law.
341 Article 61 of the OAS Model Law.
342 B Kozolchyk & JM Wilson 'The Organization of American States: the new Model Inter-American Law on Secured Transactions' (2002) 1 *Unif L Rev* 69 at 127.
343 Also, under the Australian PPSA the parties can contract out of many of the enforcement provisions under the Act (see s 115).

the delivery of the goods or conditions of the sale or auction or any matter related to these aspects.[344] However, such agreements are permitted only if they do not influence the rights of other secured creditors or buyers in the ordinary course of business.[345]

Article 68 of the Model Law introduces an innovative notion in secured transactions law, namely the right to refer a dispute relating to the interpretation and fulfilment of the security interest to arbitration. The suggestion to use arbitration is also mentioned in the UNCITRAL Model Law and this provision in the OAS Model Law probably provided the inspiration for including ADR under the UNCITRAL Model Law.[346] Therefore, the criticism above against using ADR in the case of secured transactions under the UNCITRAL Model is equally true for the OAS Model Law.[347]

4.3.3.7 Acquisition security interest

Inventory under the OAS Model Law entails movable property that will be sold or leased by a person in the ordinary course of her business operations.[348] This is particularly relevant to acquisition financing. The OAS Model Law uses the term 'acquisition security interest', which is similar to the UNCITRAL Guide but departs from the term used in UCC Article 9, purchase money security interest (PMSI). An acquisition security interest is classified in the OAS Model Law as a security interest in the movable *corporeal* property the acquisition of which by the debtor was financed by the secured creditor (which includes a supplier).[349] This security interest may secure the purchase price of both a present and after-acquired movable property. The fact that an acquisition security interest can only extend to corporeal property excludes the possibility of this security interest being extended to attributable movable property in the form of receivables.[350] This is confirmed in article 51 of the Model Law where it is stated that the super-priority only extends to *cash* proceeds. Excluding proceeds in the form of receivables eliminates the need for an elaborate scheme which creates additional requirements for proceeds associated with inventory.[351] It is entirely possible that security devices which use the

344 Article 62 of the OAS Model Law.
345 Article 62 of the OAS Model Law.
346 See Chapter 3 paragraph 3.4.2.10 *supra*.
347 See Chapter 3 paragraph 3.4.2.10 *supra*.
348 Article 3(VIII) of the OAS Model Law.
349 Article 3(IX) of the OAS Model Law.
350 As under UCC Article 9 and the UNCITRAL Guide and Model Law where the super-priority only extends to the cash proceeds resulting from acquisition finance.
351 The UNCITRAL framework contains an elaborate scheme of alternatives, which could apply where proceeds are in the form of receivables. See Chapter 3 paragraphs 3.3.4.7 and 3.4.2.8(*a*) *supra*.

reservation of ownership may be classified as an acquisition security interest, thus making these specific rules applicable to those transactions.

The acquisition security interest must be publicised by registration to obtain the super-priority.[352] This priority is only afforded if the registration form includes mention of the special character of the acquisition security interest.[353] The route to achieving super-priority may prove cumbersome.[354] In terms of article 12, an acquisition security interest can only be publicised by the filing of a registration form which states the special character of the security interest as an acquisition security interest.[355] Furthermore, for an acquisition security interest to enjoy super-priority, article 40 requires that, before the debtor obtains possession of the encumbered property: (1) the registration form reflects the special character of the acquisition security interest;[356] and (2) the acquisition creditor must notify other creditors who already have a perfected security interests in property of the *same* kind as that in which the secured creditor intends to take an acquisition security interest.[357] This universal notification requirement is balanced, to some extent, in that the acquisition secured creditor only needs to notify those other secured creditors who already have a perfected security interest in the property of the same kind, and one notice can be used for multiple transactions.

4.3.3.8 OAS Model Law key objectives and the fundamental principles (policies)

The key objectives of the OAS Model Law were not contained in the earlier versions of the OAS Model Law itself, but rather appeared in OAS Secured Transactions Book, which contained both the OAS Model Law and the OAS Registry Regulations.[358] The fundamental principles discussed above are the 'building blocks' used to achieve key policy objectives, the latter being more general.[359] This link between these elements is illustrated in table 4.2 below.

352 Article 12 of the OAS Model Law.
353 Article 12 of the OAS Model Law. This differs from the UNCITRAL Guide where no mention is required.
354 G McCormack *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (2011) at 125.
355 This requirement is important as it is again mentioned in art 40(I).
356 Article 40(I) of the OAS Model Law.
357 Article 40(II) of the OAS Model Law.
358 OAS Secured Transactions Book available at http://www.oas.org/en/sla/dil/docs/secured_transactions_book_model_law.pdf (date of access: 10 October 2018).
359 See Chapter 1 paragraph 1.3 *supra* which discuss the inter-relationship between key objectives and fundamental principles.

	Key objectives achieved through a fundamental principle	**Research question answered through a fundamental principle**
Fundamental principles		
	Principle 1, holding security in collateral must be able to reduce the risk of giving credit, resulting in increased availability of credit on improved terms by all the fundamental principles.	
Even though it is not listed as a fundamental principle, the scope of the OAS Model Law is wide.	There is no specific key objective listed.	Research question 3: How comprehensive (or inclusive) should the scope of the secured transactions law framework be?
Applying a uniform *system* to the framework, not necessarily using a unitary approach.	Having a simple process for the creation of the security interest.	Research question 1: Does a single legal framework result in an effective secured transactions law framework?
A clear distinction between security rights being effective *inter partes* (creation), or against third parties (third-party effectiveness).	Having a simple process for the creation of the security interest.	Research question 2: Should the method of creating a security right be revised?
Publicity must take place through registration in a public registry, while possession in respect of certain types of assets is still allowed.	The promotion of trans-parency by establishing clear requirements for publicity.	Research question 4: What is the best method the achieve third-party effectiveness?
Priority rules should be clear and predictable.	Establishing a 'foreseeable and detailed' criteria to establish the priority ranking.	Research question 5: How predictable and transparent are the current priority rules?
To allow extrajudicial enforcement under the OAS Model Law	Efficiency requires that enforcement must be quick, while also balancing the protection of the debtor.	Research question 6: Is the current South African legal framework concerning the enforcement of creditors' security rights the most efficient option?

Table 4.2 Interrelationship between (1) the key objectives and fundamental principles contained in the OAS Model Law, and (2) the research questions of the thesis.

4.3.3.9 Concluding remarks: the OAS Model Law

The policy under the OAS Model Law is undeniably creditor-friendly,[360] similar to the approach in the EBRD Model Law. Although the OAS Model Law shares some commonalities with UCC Article 9, there are marked differences between the instruments. For example, the OAS Model Law recommends the adoption of a unitary system as opposed to the unitary approach under UCC Article 9. This means that the separate classification of traditional

[360] AM Garro 'The OAS-sponsored Model Law on Secured Transactions: gestation and implementation' (2010) 15 *Unif L Rev* 391 at 394, 411.

security devices is maintained, but that a uniform system in respect to registration, priority, and enforcement is applied to all security devices. This is, of course, unless there is a valid policy-driven reason to exclude a security device from the application of a uniform rule. As under the UNCITRAL instruments, a non-possessory security interest is created as a result of concluding a security contract. But in contract to the UNCITRAL instruments, a security right is not defined as a 'property right'. However, article 2, which deals with the scope of a security interest provides that the interest is 'created contractually over one or several specific items of movable property'. Thus, it can be deduced that a security interest is a right in a property or a property right.

The primary method of publicity remains registration in a registry in the form of notice-filing. Nevertheless, control and possession remain as alternatives to accommodate the publicity of specific types of asset.

The general rule in respect of priority is also *prior tempore potior iure*, with the same exceptions to this general rule recognised in other legal instruments, and applied in terms of the OAS Model Law.

In respect of enforcement, the OAS Model Law does not suggest extrajudicial dispossession, but rather that expedited judicial proceedings be used where repossession takes place subject to a court order. The concept of ADR is also introduced as a possible enforcement mechanism, as is suggested in the UNCITRAL Model Law.

4.4 Conclusion: components of the regional framework relevant to reform

The EBRD Model Law and OAS Model Law are regarded as precursors to the UNCITRAL instruments. Even though the correlation may not be apparent at first glance, the regional instruments share a commonality in their general theme and in dealing with similar important components of a secured transactions law framework – albeit in different ways. The tone and substance of the EBRD Model Law are very different from those of the OAS Model Law. The OAS Model Law is much closer to the tone of UCC Article 9, but even more so to the substance of the UNCITRAL instruments. Nevertheless, neither the EBRD Model Law nor the OAS Model Law follows the form of the unitary approach included under UCC Article 9 and the UNCITRAL instruments, as there is no recharacterisation of traditional security devices as a security right (or interest) under the regional model laws. Even though the OAS Model Law refers to a security interest, the separate labels assigned to traditional security devices remain.

The OAS Model Law uses a unitary system, where a right under traditional security device (eg, a pledge or mortgage) which complies with the definition of a security interest, will be subject to a unitary system of registration, priority, and enforcement, but follows a functional approach to all security interests. The OAS Model Law remains somewhat confusing when referring to a unitary system of registration and priority, specifically to whether or not possessory security interest is subject to the uniform registration system. Conversely, the EBRD Model Law applies a formalistic approach. A single type of security device (a charge) creates a proprietary right in collateral. The proprietary right under the OAS Model Law is created contractually (when the security agreement is concluded) whereas the EBRD Model Law requires an additional constitutive action (publicity) unless it is an unpaid vendor's charge.

4.4.1 Should a unitary or non-unitary approach to a secured transactions law framework be followed?

Both the EBRD Model Law and the OAS Model Law do not reclassify all security devices as the unitary concept of a security right, thus implementing a non-unitary approach. The approach between the regional model laws is not only different *inter se*, but is a departure from the both the UCC Article 9 approach and the UNCITRAL instruments. The EBRD Model Law uses a single security right in the form of a charge, but then distinguishes between four different types of charge, each subject to unique rules which only apply to that specific charge. Consequently, the EBRD Model Law follows a formal approach. Despite not following a functional approach, the provisions in the EBRD Model Law make commercial and practical sense. Perhaps this illustrates that a framework can remain effective even where a non-unitary approach is applied. Maybe more important than applying a unitary or functional approach, is to have a framework with clear rules in respect of the different security devices (charges) and then allow enough flexibility in respect of the type of assets and obligations secured by different types of secured transaction. Also, provided that the rights under a title-based security device are sufficiently publicised – regrettable not the case under the unpaid vendor's charge in the EBRD Model Law – there may be no need to create a uniform framework in respect of traditional or *quasi*-security rights. The better solution is to move the rules in respect of these types of security device closer together (as was the attempt with the non-unitary approach under the UNCITRAL Guide).

Also, the OAS Model Law implements a uniform system in respect of registration (or third-party effectiveness for non-possessory security interests), priority, and enforcement. However, there is no reclassification of traditional security devices. Consequently, the legal rules which applied to the traditional security devices continue to exist, but the OAS Model Law suggests additional rules that should be added to allow the possessory and non-possessory security devices to function as part of a single framework. Other than the EBRD Model Law, the OAS Model Law does use the functional approach as is particularly evident in the requirement that a title-based security device must be registered to be effective against third parties. Essentially, the OAS Model Law recommends taking the existing security devices, retaining them in name to some extent, but then where the domestic security device complies with the definition of a security interest, applying certain uniform rules. The EBRD Model Law does not necessarily recommend keeping existing security devices (more correctly the 'labels' assigned to each) but draws a clear distinction between four species of the type of security device (a charge), each type with a specific purpose and clearly defined rules.

4.4.2 Should the method for creating a security right be revised?

Creation coincides with third-party effect under the EBRD Model Law. In respect of a non-possessory security interest, the OAS Model Law follows the UNCITRAL approach in terms of which the security interest is created via an agreement, but third-party effect is achieved by a further act of publicity. The OAS Model Law does not define a security interest as a 'property right'. However, article 2 states that the security interest over movable property is created contractually. Perhaps, by not defining a security interest directly as a 'property right', the OAS does not create any expectation that a security interest will be similar to the traditional notion of a 'property right'. On the other hand, under the EBRD Model Law, a charge is a limited right in property and creation, and third-party effect occurs simultaneously; thus, this right is a traditional property right.

Further, under the EBRD Model Law, the unpaid vendor's charge need not be registered, but the rights under this charge rank higher than rights under the other types of charge. However, it is probably preferred that any right which grants a super-priority on the holder should be registered, as is the case with an acquisition security interest under the OAS Model Law. Even though the charge will be effective against a third party as soon as it is created, the EBRD Model Law framework can accommodate future assets (using the registered charge)

and revolving assets (using the enterprise charge). Also, nothing prevents the debtor from granting multiple charges in a single asset. In terms of the EBRD Model Law, the multiple charges will be properly publicised, and the priority ranking will also be clear (excluding the unpaid vendor's charge). However, the unpublicised vendor's charge does muddy the waters somewhat due to the higher priority it affords without requiring any form of publicity.

In terms of the OAS Model Law, non-possessory security interests are created through a written security contract (art 6). The OAS Model Law, also does not recommend the application of the accessory principle. Consequently, a security interest may be created without the principal loan agreement first having to be in place.

Nevertheless, there is no convincing reason why there should be a clear separation between the creation and the third-party effectiveness of the security right. The EBRD Model Law will function just as effectively, probably more so, compared to the OAS Model Law.

4.4.3 How comprehensive (or inclusive) should the scope of the secured transactions law framework be?

A modern and commercially relevant secured transactions law framework must be as comprehensive as possible as regards the assets, secured obligations, and the type of secured transactions it can accommodate. In respect of the scope of assets, both the EBRD Model Law and OAS Model Law extend to future assets and revolving assets.[361] Nevertheless, only the OAS Model Law contains direct provisions as to the extension into a mass or a product (as per the reference to after-acquired movable property) and the attachment of the movable property to immovable property. Potentially, as the EBRD Model Law contains no direct provisions in this regard, it will be left up to domestic law to inform whether a charge can extend into a mass or a product. The reference to a thing or right attached to the charged property, is too general to constitute a general rule, but this is, after all, not contrary to the theme of the EBRD Model Law to allow domestic law to fill in the gaps, so to speak, where the Model Law is not sufficiently clear on an aspect.

The introduction of the enterprise charge is a valuable recommendation under the EBRD Model Law, and the functional equivalent under the OAS Model Law is an 'all-assets' security interest in all the debtor's assets. The enterprise charge under the EBRD Model Law is taken

361 This is implied from the wide definition of assets and obligations in both instruments.

in respect of all of the enterprise's assets. Nevertheless, using an enterprise charge presents some challenges. Firstly, it provides the chargeholder with a monopoly in respect of all the debtor's assets. Also, as the enforcement measures resemble corporate rescue proceedings (the aim is to get the enterprise in shape to sell as a going concern), the separate enforcement measures must be in line not only with insolvency law, but also with specific corporate law provisions dealing with business (corporate) rescue. Conversely, the OAS Model Law does not contain a direct provision on taking an entire business as security, but essentially an 'all-assets security interest' will have the same effect as an enterprise charge.

Under the EBRD Model Law, the higher priority in the case of proceeds resulting from an unpaid vendor's charge will never extend to any resulting proceeds. However, under the OAS Model Law, the super-priority extends to *cash* proceeds only, similar to the approach under UCC Article 9 and the UNCITRAL framework. Nevertheless, the approach under the UNCITRAL instruments to extend the super-priority to funds credited to an account remains the preferred option. Correctly, neither regional instrument extends any super-priority in respect of proceeds in the form of receivables.

The two regional frameworks deal with title-based security devices in very different ways. The OAS Model Law recommends that an acquisition security interest must be registered and that the enforcement measures which apply to other security interests must apply equally to an acquisition security interest. Conversely, the unpaid vendor's charge need not be registered, but still provides the holder with priority above other chargeholders. However, when it comes to enforcement, the EBRD Model Law makes no mention of enforcement measures applicable exclusively to a vendor's charge.

4.4.4 What is the best method to achieve third-party effectiveness?

Both regional instruments require registration for third-party effect in respect of non-possessory security devices – the OAS Model Law in the form of notice filing, and the EBRD Model Law in the form of transaction filing. However, the EBRD Model Law follows the approach of some European countries by not requiring that the unpaid vendor's charge (the functional equivalent of an acquisition security interest or a retention-of-title) be registered. In essence, this creates a 'secret security right' which also conveys a higher priority in respect of only one category of secured creditor (the vendor). The main concern is whether the legal nature of the right in terms of the unpaid vendor charge will change if it is required to be

registered. Whether registration is required may be more a practical or economic consideration than a purely legal one.[362] Ultimately, the main question is what would fit practically into the secured transactions law framework (fit-to-context). Where including registration as a requirement may have a negative economic impact, a national legislator will be hesitant to include this as a requirement. This is even more that case where the main trading-partner countries do not use a registration system for title-based security devices.

Further, the regional model laws discussed in this chapter use different forms of registration. The OAS Model Law uses notice filing, while the EBRD Model Law makes use of transaction-filing. If it is assumed that the security right under both model laws is a property right, the next aspect to consider is whether the registration method influences whether the creation and effectiveness against third parties, is either separated or takes place simultaneously. The submission is that whether a country adopts either notice-filing or transaction-filing, should not influence whether there is a clear separation between the creation and effectiveness against third parties and *vice versa.* Indeed, transaction-filing will be possible even where there is a clear separation between creation and third-party effect. Nevertheless, in this instance, *advance*-filing will not be possible as the security agreement must be presented at filing.[363] Thus, in practical terms this means that the security right has already been created before filing takes place. Accordingly, an important consideration is whether the framework recommends advance-filing or not, and further whether the advance-filing is still required despite the framework anyway applying in respect of future assets. It does seem more likely that a registry will be swamped where advance-filing is permitted. It could then be that the Belgian approach of requiring that a pledge agreement must be signed before the filing can take place, is the better option.

4.4.5 Efficiency of enforcement mechanisms

Essentially, the difference between the enforcement measures under the EBRD Model Law and the OAS Model Law are founded on whether the model law relies exclusively on extrajudicial repossession and disposition, or whether the model law incorporates expedited judicial

362 A retention-of-title right is also not registered in terms of the Belgian Pledge Act of 11 July 2013. See E Dirix & V Sagaert 'The new Belgian Act on Security Rights in Movable Property' (2014) 3 *EPLJ* 231 at 253. Nevertheless, the Act contains provisions to safeguard the buyer (debtor) against potential prejudice. For example, art 72 contains a prohibition on enrichment where the seller needs to refund any surplus remaining after the sale of the encumbered property to the debtor.

363 This was the approach introduced by the Belgian Pledge Act of 11 July 2013. See E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 247.

enforcement. The EBRD Model Law recommends extrajudicial repossession and disposition and limits court involvement to where the debtor or an interested party has suffered loss or damages as a result of the enforcement of the charge. However, the OAS Model Law does not recommend extrajudicial repossession, but incorporates expedited judicial proceedings for repossession, but at the same time allows extrajudicial disposition. The only requirement for expedited judicial proceedings to take place is whether the debtor is in arrears or not. Any other considerations on the merits of a case will take place through a separate judicial proceeding, but this will not influence whether the secured creditor can proceed with enforcement (both repossession and disposition). Nevertheless, it does not seem as if the debtor needs to consent to disposition and, in an attempt to balance potential prejudice against the debtor, the debtor may claim damages against a creditor who has abused its enforcement rights.

The enforcement measures under the EBRD Model Law rely exclusively on extrajudicial repossession and disposition. Also, even though the debtor receives adequate notice of the impending enforcement measures, she is not required to consent to enforcement before it can take place. In specific circumstances, a chargor, another chargeholder in the same property, or any other person with a claim in the charged property, potentially has an action for damages. The loss includes any loss suffered as a result of the enforcement measures. It should be asked whether this broad right to claim damages balances out the fact that the entire enforcement process takes places neither with the debtor's consent, nor after court intervention. The enforcement measures under the EBRD Model Law amount to self-help and it is doubtful whether national laws will incorporate this approach to enforcement.

4.4.6 How predictable and transparent are the current priority rules?

Both instruments rely on a first-in-time, first-in-right approach. The exceptions in respect of the priority rules are the same under both the EBRD Model Law and the OAS Model Law.

Under the EBRD Model Law, there is a higher priority for acquisition financing without any registration, but the priority is only valid for six months, whereas the OAS Model Law sets cumbersome requirements for the security interest to qualify as an acquisition security interest.

4.4.7 Equal treatment of creditors who provide credit to debtors to acquire movable property

The EBRD Model Law favours vendor-based financing, as the unpaid vendor's charge applies only to the seller of assets sold using a title-based security device. The unpaid vendor's charge need not be registered and attracts a higher priority above all other charges for six months. In the case of lender-based financing, the secured creditor most probably needs to use a registered charge. A right under a registered charge will rank below a right under an unpaid vendor's charge. To favour the seller in vendor-based financing is more a practical or economic choice, than purely a legal consideration. As is evident from the recent Belgian reform, the retention-of-title device need also not be registered. However, in the Belgian example an attempt was made to remove some of the potential risk factors from this device, especially in respect of the effect of enforcement measures on the debtor. But this right also remains a 'secret security right'.

The OAS Model Law influenced the non-unitary approach in the UNCITRAL Guide. An acquisition security interest will include both vendor-based and lender-based financing. The super-priority afforded to an acquisition security right is firstly dependent on registering the right as an acquisition security right in the original notice filed. After that, there are additional notice requirements that must be met before this right can be accorded priority over other security interests. Accordingly, an acquisition security interest is not a 'secret security right'.

4.4.8 Concluding remarks

Both regional instruments offer diverse alternatives to the implementation of similar fundamental principles which may be included as part of a secured transactions law framework. Nevertheless, selective borrowing should be the correct approach when those principles, which are fit-to-context, are incorporated into a domestic framework. The important question of which approach (or combination of approaches) will be best suited to reform the South African real security law framework for corporeal movable property to be effective, remains. What would be fit-to-context for South African is the question answered in Chapter 5.

CHAPTER 5
AN EFFECTIVE SECURED TRANSACTIONS LAW FRAMEWORK PROPOSED

5.1 Introduction and chapter purpose

The purpose of this thesis is to determine to what extent the South African legal framework concerning security rights in movable property should be reformed to make it effective. For the purposes of this study, an effective framework is one which can be regarded as legally efficient. Chapter 1 introduced the elements of legal efficiency, and these elements are revisited in 5.2.1 *infra*. The elements of the legal efficiency test provide the benchmark to determine whether implementing specific fundamental principles will result in the South African legal framework being more effective.

Chapter 2 discussed the current South African framework. The aspects of the current framework in need of reform were emphasised and the fundamental principles and ground rules which shaped the current framework were identified. Chapter 3 analysed international secured transactions law frameworks, while Chapter 4 analysed regional secured transactions law frameworks. From this analysis elements were drawn which, if implemented, would create an effective secured transactions law framework.

The legal frameworks analysed in Chapters 3 and 4 recommend different approaches to reform, yet the commonality between the key policy objectives and fundamental principles at the core of the frameworks, is unmistakable.[1] Therefore, to achieve the aim of this thesis, a combination of key policy objectives and fundamental principles, suited to the South African context, must be found. The basis for the key policy objectives and fundamental principles I recommend hinges on merging the elements of both as articulated in the frameworks analysed. The chapter concludes by recommending key policy objectives and fundamental principles that the South African legislature and policymakers should consider for the reformed South African secured transactions law to be effective.

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[1] See Chapter 1 paragraph 1.3 *supra* for the interrelationship between key policy objectives and fundamental principles. Indeed, Akseli also confirms that the key objectives of most international instruments are practically the same. See in this regard, NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 45.

5.2 Interrelationship between the recommended key policy objectives, the fundamental principles (or policies), and legal efficiency

A key policy objective embodies the legal reform goals legislative drafters intend to achieve by introducing a specific legal framework.[2] Similarly, the concept of 'legal efficiency' denotes the extent to which the law is used to achieve the positive outcomes – principally economic – envisioned when promulgating such law.[3] Arguably, including those key policy objectives and fundamental principles – meeting the criterion for legal efficiency – will result in an effective secured transactions law framework. Therefore, including *specific* key policy objectives – those meeting the benchmark for legal efficiency – would make the secured transactions law framework effective. For this reason, we revisit the elements of the legal efficiency test in the next paragraph to provide a contextual foundation for the application of these elements as part of the framework recommended for future reform in South Africa.

The first part of this paragraph, 5.2.1 *infra*, explains the elements of legal efficiency with reference to how each element can be identified in a secured transactions law framework. Thus, I include my point of view on how the elements of the legal efficiency test would feature in a reformed secured transactions law framework. Thereafter, 5.2.2 *infra* describes the approach that will be followed, culminating in the recommended key policy objectives and fundamental principles which would serve as the foundation of an effective South African legal framework for security rights in movable property.

5.2.1 The elements of legal efficiency

Legal efficiency depends on whether the secured transactions law framework meets its intended legal function and operates in a way that maximises the economic benefit resulting from the framework.[4] To maximise economic benefit the framework must facilitate the speedy, simple, but cost effective creation and enforcement of a security right in a legal system which

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2 See Chapter 3 paragraph 3.3.2 *supra*.

3 F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 132.

4 See Dahan and Simpson's theory discussed and recommended in Chapter 1 paragraph 1.2 *supra*.

is certain and suited to the context of the country – is fit-to-context.[5] The final component – the 'fit-to-context' requirement – implies that a *unique* combination of fundamental principles (policies), which achieve specific key policy objectives, makes a *particular* country's framework legally efficient.

The primary legal function is to establish a legal system that provides the secured creditor with a definite level of legal certainty. This legal certainty is particularly relevant when the debtor defaults. On default, the law should allow the creditor to recover a substantial portion of the debt with relative ease. I argue that this legal certainty should not only become apparent when the default takes place, but that the creditor must have assurance regarding her rights throughout the credit cycle. Therefore, the 'legal function' cuts across all components of the secured transactions law framework, be it the creation, third-party effect, priority ranking over other creditors, and, importantly, the ability to enforce one's security right against third parties. In summary, the legal function of secured transactions law deals with the extent to which the legal rules can reduce the creditor's risk inherent in advancing funds to the debtor. The following paragraphs expand on those elements which maximise the economic benefit of secured transactions law, the second leg of the legal efficiency test.

5.2.1.1 The simplicity of the legal framework

An ideal secured transactions law framework must be simple, yet its provisions must not be 'dumbed-down' to the extent that they no longer hold any practical or legal relevance. Practical relevance implies that the framework can adapt to what modern commerce requires from a legal framework.[6] A framework is legally relevant where specific key concepts remain part of the secured transactions law framework so that the framework fits into a broader domestic legal system. In my assessment, the solution presents itself after examining the legal and commercial context within which the framework should function, and establishing what would be the simplest version of the framework that retains the essential legal principles while meeting the commercial needs.

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5 F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 134.

6 F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 134.

The simplicity of the framework is, in the main, associated with how cumbersome it is to create a security right in movable property. Therefore, the degree of simplicity of the framework links to the question of whether there is a clear separation between the creation (*inter partes* application) and third-party effectiveness (*erga omnes* enforceability) of a security right.[7] In turn, this distinction goes back to the relevance of classifying the security right as a traditional property right or as a *contractually*-created property right. Essentially, a traditional property right is effective against the world, while a contractually-created property right is not effective against the world unless and until the publicity principle has been satisfied.

On face value, the unitary approach to secured transactions law is the most straightforward approach.[8] A more sophisticated alternative is a non-unitary approach which incorporates a uniform system of rules that apply to the creation (where possible),[9] third-party effect, priority, and equal enforcement of *all* types of security device. A non-unitary yet functional approach should merge the parallel principles applicable to different categories of security device into a single uniform system, while retaining the separate 'labels' for security devices. This hybrid approach is required for different types of security device to co-exist as functional equivalents in a uniform legal system. Adopting the hybrid approach requires that the legal rules applicable to the different security devices move closer to one another in application. In other words, the same rules would apply to a functionally equivalent security device unless stated otherwise. However, it is particularly challenging to merge the legal rules that apply to title-based security devices into a secured transactions law framework with general application.[10] Consequently, in my view the most straightforward solution for South Africa at present is to maintain a separation between security devices used for a specific purpose, but ensure that the legal rules which apply to each fulfil a specific purpose and are sufficiently clear.[11]

5.2.1.2 Costs associated with operating the framework

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7 I recommend against implementing a clear separation between the creation and third-party effectiveness in the South African reform. See paragraph 5.4.3.2 *infra*.

8 The 'unitary approach' is explained in Chapter 1 paragraph 1.1 *supra*.

9 For example, under the OAS Model Law, the traditional security devices are kept, and the uniform system only applies to registration, priority, and enforcement. See Chapter 4 paragraph 4.3.3.1 *supra*.

10 See paragraph 5.4.1.1 *infra* for a discussion of when a framework attempts to apply the same rule to a security right and a right in respect of a title-based security device.

11 This is also the recommendation made in paragraph 5.4.1.3 *infra* for the South African reform.

The general assumption, which I also make, is that greater availability of credit will lead to a reduction in the cost of credit. More credit is presumably available where the debtor can use the full inherent value of her assets as security.[12] However, I also contend that adopting specific key policy objectives and fundamental principles will potentially result in a reduction in the costs associated with operating the framework. If it is expensive to create and subsequently enforce the security right, the cost of credit will increase. Consequently, the aim should be to achieve a balance between the cost associated with creating and enforcing a security right, and the overall value the parties receive from using the framework.[13]

The cost of creating a security right depends, amongst other factors, on whether the creation and third-party effect occur simultaneously. Where there is a clear separation between creation and third-party effectiveness, the security right is potentially created with very little, if any, expense. Therefore, a simple yet efficient way of creating a security right will lead to reduced cost.[14] However, where there is no clear separation of the creation and third-party effectiveness of the security right, there should be some form of publicity. The cost of such publicity influences the overall cost of credit.[15]

The cost of credit also reduces where the system allows for efficient enforcement of security rights.[16] Extrajudicial enforcement is quicker due to avoiding court involvement and has the concomitant benefit of reducing enforcement cost.[17] But so do *expedited* judicial proceedings but they offer the added benefit of promoting legal certainty through the knowedge that the matter has been heard by a court.[18]

5.2.1.3 Promptness of the framework

The promptness of the framework concerns: (1) the period between the creation of the security right and when the right attains third-party effect; and (2) the time it takes to enforce the

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12 Recommendation 1(*b)* of the UNCITRAL Guide. See also the recommendation concerning including a more comprehensive scope as part of the South African reform in paragraph 5.4.2 *infra* which will reduce the cost along with implementing a single legal framework as recommended in paragraph 5.4.1 *infra.*

13 See the recommendation that the creditor's enforcement rights must be as broad as possible in paragraph 5.4.7 *infra.* The recommendation should result in a reduction in the cost of enforcement by avoiding a lengthy court process to enforce the security right.

14 Recommendation 1(*c*) of the UNCITRAL Guide.

15 See the recommendation I make in paragraph 5.4.4.2 *infra* on establishing an electronic general registry as part of the South African reform.

16 Recommendation 1(*h*) of the UNCITRAL Guide.

17 The speed of enforcement measures, discussed in the next paragraph, will influence the cost of credit.

18 See the recommendation I make in paragraph 5.4.7.2 *infra* on reforming the enforcement measures included as part of the South African framework.

security right in the event of the debtor's default.[19] Logically, any legal process which takes less time will be more efficient.[20] All the frameworks that form part of this study share the key policy objective of a speedy enforcement process. Nevertheless, the promptness of the framework must be balanced against allowing sufficient time, where required, for the framework to operate effectively, and incorporating sufficient safeguards to protect the debtor.[21] One example of a safeguard is where additional notice requirements must be met to secure a higher priority ranking.

5.2.1.4 The certainty of the framework

A legal framework cannot be regarded as sound if it does not result in legal certainty.[22] However, in my view, there should be a trade-off between having a simple legal framework and having a reduced level of legal certainty. Considering the difficulty of quantifying the level of legal certainty,[23] particular challenges arise when performing the 'balancing act' of establishing a legal framework that is both sufficiently simple and sufficiently certain. The simplicity of the framework reduces legal certainty for the creditor. The only workable answer, in my view, is that the creditor must have certainty on the risks associated with a simplified legal framework so as to allow her to implement additional measures to mitigate these risks. Particular aspects of a secured transactions law framework determine whether the framework is certain. The first aspect is whether the framework is able to create security rights which are transparent. Moreover, clear rules to determine the priority ranking of creditors will make a legal framework certain. Further, a framework is predictable when there is greater certainty regarding what is expected from an enforcement process.[24] A framework is also certain from

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19 See the recommendation that the creditor's enforcement rights must be as broad as possible in paragraph 5.4.7 *infra*. The recommendation should result in prompt enforcement by avoiding a lengthy court process to enforce the security right.

20 F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 134.

21 For example, notice or cooling-off periods included as examples in F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 134.

22 F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 135.

23 F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 135.

24 See the recommendation I make in paragraph 5.4.7 *infra* that without having to contend with judicial discretion to grant a court order, the enforcement framework becomes more certain.

the perspective of the secured creditor, if the security right continues to exist after the debtor becomes insolvent.[25]

The purpose of transparency, a fundamental principle of property law, is to achieve certainty.[26] The principle of transparency consists of the publicity principle and the specificity principle. Accordingly, the extent to which certainty in respect of the creation of the security is achieved depends on: (1) how the security right is publicised; and (2) how detailed the publicised information must be to create sufficient legal certainty.[27]

Sufficient certainty entails broadcasting just enough information to inform third parties that a security right potentially exists in an asset, which links to the specificity with which the encumbered asset and principal obligation are described in the registration documents. Where the creditor knows that a security right exists, examining the exact scope of the right would in any event form part of the standard credit assessment process. Arguably, a creditor who knows that a security right exists would be comfortable with reasonably *sufficient* information with regard to potential encumbrances that exist in the movable property.

The secured creditor must also be certain of her priority ranking in respect of the security she holds. In determining priority ranking, the general rule, first-in-time is first-in-right, usually applies.[28] Nevertheless, it is possible to carve out *specific* exceptions to the general priority rule. When a general priority rule applies, coupled with a closed list of predictable exceptions, one can say that the priority rules are certain enough.[29]

The crux is that the creditor must be able to determine the level of certainty that would enable her to be certain about which uncertainties (or risks) she must guard against when deciding to extend credit to a particular debtor.

5.2.1.5 Fit-to-context

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25 See the recommendation I make in paragraph 5.4.5.2 *infra* regardiing the standard that should be applied in establishing transparent priority rules.

26 See Chapter 2 paragraph 2.3.3.1 *supra* for a discussion of 'transparency' as a fundamental principle that forms part of the South African framework.

27 See the distinction between transaction-filing and notice-filing at paragraph 5.5.4.1 *infra* and the recommendation in paragraph 5.5.4.2 *infra* that transaction filing will be better suited to the South African reform.

28 See the discussion of this rule in paragraph 5.4.5.1 *infra.*

29 I also suggest a closed list of exceptions for the South African reform in paragraph 5.4.5.2 *infra.*

The fit-to-context requirement carries the most weight in the legal efficiency test.[30] Whereas the other requirements discussed *supra* apply generally, this requirement refers to the specific context of the reforming country. The fit-to-context requirement essentially means that the secured transactions law framework should be adapted 'to the economic, social and legal context' of the reforming country – South Africa for purposes of this study.[31] It is useful to have a model law or legal template, but without considering the local traditions and legal context, the complicated subject area of secured transactions law will probably not function effectively. To be able to adapt to the country-specific legal context, the current fundamental principles and ground rules of the property law of the reforming country must be understood.[32]

5.2.2 The key policy objectives and fundamental principles recommended for an effective South African framework: approach explained

The modern functional comparative approach requires finding the common comparative denominator (a *tertium comparationis*) between legal frameworks, which would make a comparative legal study – a vertical comparative study in this thesis – possible.[33] The common comparative denominators for this thesis are the key policy objectives, fundamental principles (or policies), and legal rules (both ground rules and the technical rules) evident in the frameworks analysed This, then, informed my choice of which key policy objectives and fundamental principles should be included in the framework recommended for South Africa.[34] The purpose of paragraphs 5.3 and 5.4 *infra,* is to establish which combination of key policy objectives and fundamental principles, if adopted, would make the South African real security law framework more effective. The discussion of the key policy objectives is concise when compared to the discussion of the recommended fundamental principles. The key policy objectives provide the over-arching reform goals, whereas the detail forms part of the fundamental principles discussed in paragraph 5.4 *infra.*[35]

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30 F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 135.

31 F Dahan & J Simpson 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' in F Dahan & J Simpson (eds) *Secured Transactions Reform and Access to Credit* (2008) at 135.

32 See the South African fundamental principles and ground rules in Chapter 2 paragraph 2.3.3 *supra*.

33 See Chapter 1 paragraph 1.5 *supra* for a discussion of the application of the *tertium comparationis* (at 1.5.1) and the application to the modern functional approach (at 1.5.2).

34 See the comparison of the key policy objectives and fundamental principles illustrated in annexures 1 and 2 *infra*.

35 The detail will be included either as ground rules or technical rules in the South African framework.

It is not my intention to suggest a draft Bill, but rather to recommend the key policy objectives and fundamental principles that should form part of a future statute. The purpose, ultimately, is to present a blueprint framework for how the South African legal framework for security rights in movable property should be reformed. Accordingly, the recommended framework must lay the foundations for the policy decisions that will need to be taken when reforming the South African framework. The remainder of this chapter, therefore, recommends the components of an integrated framework for reforming the South African real security law.

5.3 The recommended framework for reforming the South African law of security rights in movable property: key policy objectives

Usually, the key policy objectives legislators wish to achieve can be found in the section or article of the statute which explains the purpose of the legal instrument.[36] There are two approaches to the key policy objectives of a secured transactions law framework: (1) incorporating key policy objectives that are more generic in nature; or (2) incorporating key policy objectives that are more specific, similar to the key policy objectives discussed in this thesis. Dahan postulates that more generic key policy objectives include: (1) that the secured transactions law framework should be simple and efficient; (2) it should allow creditors enough flexibility to structure the security transaction; (3) it should harmonise secured transactions law to encourage cross-border trade; and (4) it should achieve transparency and fairness in the framework.[37]

This study recommends adopting the *specific* key policy objectives *infra* as part of the reformed South African legal framework. As mentioned *supra*, the key policy objectives are achieved by implementing specific fundamental principles. Thus, the recommended key policy objectives provide general reform goals. These reform goals will be achieved when the fundamental principles recommended in 5.4 *infra* are adopted. Accordingly, each recommended key policy objective is couched in more general terms, whereas each recommended fundamental principle reflects specific reform suggestions.

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36 For example, see the long title of the Zambian Movable Property (Security Interest) Act 3 of 2016 (Zambian Movable Property (Security Interest) Act) and s 3 (Objects) of the Kenyan Movable Property Security Rights Act 13 of 2017.

37 F Dahan 'A single framework governing secured transactions law?' in F Dahan (ed) *Research Handbook on Secured Financing in Commercial Transactions* (2015) at 67-68 (listing these objectives) and 68-81 (discussing these objectives). Although these objectives are aimed at broader harmonisation, they can equally apply to a domestic framework.

5.3.1 An effective legal framework must improve access to credit granted on favourable terms

The overarching objective of any secured transactions law reform should be to promote access to credit (or finance).[38] The first key policy objective recommended for South Africa is therefore based on the broadly-held assumption that the cost of credit reduces when the framework regulating security rights in movable property, is effective. An effective framework not only reduces the actual costs associated with taking and maintaining the security right, but also reduces the creditor's risk that she may not recover the debt still owing when the debtor defaults. Accordingly, the creditor can price the credit risk in a downward direction.[39] Further, the increased availability of *secured* credit potentially supports financial stability in the financial sector.[40] The reason for this is that increased secured lending ultimately reduces the capital amount banks are required to maintain.[41]

The legal frameworks analysed in this thesis refer to 'low-cost' or 'cheap' credit. Nevertheless, the objective should not be cheap credit, but rather affordable credit granted on improved terms.[42] These improved terms should go beyond a low interest rate and include: (1) allowing a longer loan repayment period (thus improving the debtor's cash flow); and (2) requiring the debtor to provide less collateral to secure the loan.

5.3.2 The legal framework must facilitate the use of any type of movable property as security in the broadest possible sense

This key policy objective relates to extending the pool of movable property the debtor can offer as collateral.[43] Realistically, some assets should not be used as security. In this instance, a clear

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38 This objective was the general aim of reform put forward in the Scottish Law Commission 2017 (1) report at 3. Further, this key policy objective is achieved by adopting all the fundamental principles recommended in paragraph 5.4 *infra*.

39 'Pricing' refers, in the main, to the interest rate charged, but a creditor may also charge an implementation or administration fee, which is also depended on the risk the creditor is taking to advance credit.

40 See generally, GG Castellano & M Dubovec 'Credit creation: reconciling legal and regulatory incentives' (2018) 81 *Law & Contemp Probs* at 63-85; SL Schwarcz 'Secured transactions and financial stability: regulatory challenges' (2018) 81 *Law & Contemp Probs* at 46-62 and GG. Castellano & M Dubovec 'Global regulatory standards and secured transactions reforms: at the crossroad between access to credit and financial stability' (2018) 41 *Fordham Int'l LJ* at 531-588.

41 Beyond pointing out that an interrelationship exists, the discussion of the interrelationship between secured lending and financial stability is not taken further in this study.

42 See a similar recommendation in EBRD Core Principle 1.

43 Two recommended fundamental principles should fulfil this key policy objective: (1) adopting a single legal framework which regulates all secured transactions (para 5.4.1 *infra*); and (2) including a framework with a comprehensive scope (para 5.4.2 *infra*).

rule to exclude specific movable property based on valid policy reasons, should form part of the legal framework. For example, policy choices must be made with regard to whether intellectual property, ships, and aircraft –all subject to specialised legislation – should form part of the general framework.[44] One would also carefully have to consider the country's approach to including: (1) future assets; (2) proceeds of the hypothecated assets; and (3) extending the security right to a mass or a product.[45] Furthermore, an essential component of this key policy objective relates to the application of the specificity principle when describing the asset. This is because rigid description criteria could influence the variety of assets that may be taken as collateral. As regards the level of specificity required, a balance must be sought between transparency and certainty on the one hand, and the flexibility of the framework on the other.

5.3.3 The process to create the security right in movable property must be simple and promote consistency and certainty

The legal process used to create a security right must be as simple as possible while still providing the parties to the secured transaction with the assurance that the steps followed will result in a legally enforceable security right. In short: the parties must have legal certainty.[46] Therefore, I argue that simplicity first requires the exclusion of overly formalistic rules that serve no clear legal or commercial purpose – in other words, incorporating a rationalised procedure by minimising formalities.[47] Those rules that merely prolong the process should be excluded. However, the requirements (rules) for the creation of a security right must not only be certain; they must be applied consistently to all security devices involving movable property. Any deviation from the rules of creation must be grounded in a valid policy reason, and the rules that apply to the variation must be specific.

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44 The recommendation for the South African reform, made in paragraph 5.4.2.1(*a*) *infra*, is to include intellectual property but exclude aircraft and ships.

45 See the recommendation contained as part of the fundamental principle discussed in paragraph 5.4.2 *infra* concerning the recommended South African approach.

46 This key objective is fulfilled by implementing the fundamental principle that a simple process for creating the security right must be adopted while maintaining a security right that fulfils the essential qualities of a property right (para 5.4.3 *infra*).

47 See a similar objective under the Zambian Movable Property (Security Interest) Act.

5.3.4 The law should facilitate the creation of a proprietary security right in movable property without having to dispossess the debtor

It is widely accepted that it no longer makes commercial sense for the debtor to be required to hand over an income-generating asset to the creditor. Accordingly, it is advisable – indeed indispensable – that the framework should include an effective non-possessory security device for all types of movable property (corporeal and incorporeal).

However, as the creditor would no longer possess the collateral, she should be adequately protected against the risks associated with the lack of possession. Adequate safeguards include: (1) having sufficient transparency throughout the entire process; and (2) allowing extrajudicial enforcement – or at least expedited judicial enforcement – but subject to adequate protection of the debtor's rights.[48]

5.3.5 The law should promote transparency by establishing clear publicity rules and adopting specificity rules that create adequate legal certainty

Transparency should remain a fundamental principle of South African property law.[49] However, the trade-off arises when one introduces the flexibility necessary to ensure a comprehensive scope of application but with a reduced level of transparency. The existence and particulars of an effective security right must be transparent to outsiders, considering that the security right is intended to have a third-party effect. Transparency is associated with both the publicity principle and the specificity principle.[50] Therefore, the security right must be publicised to the world with as much specificity – as regards both the asset and secured obligation – as possible. A publicity method is only effective: (1) where the publicising of the security right leads to the right becoming enforceable against third parties; (2) where an interested party can readily access the information on the *existence* of a security right via a *publicly* accessible platform; and (3) where the information retrievable from the public platform is adequate to allow the information seeker, for example, a prospective creditor, to

48 See the recommendation contained as part of the fundamental principles discussed *infra* in paragraphs 5.4.4 (registration in a general registry), 5.4.2.1(*b*) (application of the specificity principle), and 5.4.7 (creditor's enforcement rights must be as broad as reasonably possible).

49 The recommended key objective is achieved when the fundamental principle of having registration in a general registry, but also recognising secondary publicity methods (para 5.4.4 *infra*).

50 See Chapter 2 paragraph 2.3.3.1 *supra* which explains the specificity principle and publicity as components of the transparency principle.

make an informed credit risk assessment. In other words, this objective involves both the means used to achieve publicity and the level of specificity required of the published information.

5.3.6 The law must provide transparent and predictable priority rules

This objective relates to establishing 'foreseeable and detailed' criteria that a creditor may use to determine the priority of its claim even before extending the credit to the debtor.[51] This objective assumes the existence of general rules for establishing priority and that allowance is made for a limited number of exceptions to the general rules. Consequently, there should be a limited number of exception subject to predictable and clear rules as to their application. The general rule is that priority must be established on a temporal basis. Permitted exceptions could include: (1) the super-priority granted in favour of an acquisition secured creditor; and (2) the priority granted to the state, which should be kept to a minimum and only be included where there is a clear policy reason for the higher priority.[52]

5.3.7 The law should enhance the efficiency of the enforcement measures while also safeguarding parties' legitimate interests during the course of the enforcement process

The enforcement measures should be swift but still protect the debtor against an unnecessary loss resulting from speedy enforcement. These assurances against loss should be provided at the start of the enforcement process.[53] Even though a legal framework must allow for both extrajudicial and judicial enforcement, the debtor must be protected via specific safeguards against potential prejudice associated with extrajudicial enforcement. These safeguards could include: (1) that the debtor must consent to extrajudicial enforcement (preferably in the security agreement *and* after default); and (2) that the debtor should have the right to approach a court

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51 The recommended key policy objective is achieved when the fundamental principle of incorporating transparent and predictable priority rules is included. See paragraph 5.4.5 *infra*.

52 An example would be the statutory preference afforded to the South African Land and Agricultural Development Bank above other creditors (including the holder of special notarial bond and a creditor under an instalment agreement). See M Kelly-Louw 'Investigating the statutory preferential rights the land bank requires to fulfil its development role (Part 1)' (2004) 16 *SA Merc LJ* 211-240 and M Kelly-Louw 'Investigating the statutory preferential rights the land bank requires to fulfil its development role (Part 2)' (2004) 16 *SA Merc LJ* at 378-408 for a detailed discussion of these rights.

53 The recommended fundamental principle which should achieve this key policy objective is that the creditor's enforcement rights must be as broad as reasonably possible, See paragraph 5.4.7 *infra*.

whenever she has suffered prejudice as a result of extrajudicial enforcement.[54] Further, the interests of other parties should be safeguarded either by: (1) requiring that they also consent to the extrajudicial enforcement; or (2) ensuring that they receive sufficient notice of the intended enforcement.[55]

5.3.8 Concluding remarks

The key policy objectives, *supra*, provide the general policy framework for the proposed South African legal framework for security rights in movable property. However, the more detailed substance of the proposed reform lies in the fundamental principles discussed *infra*.

5.4 The recommended framework for reforming the South African law of security rights in movable property: fundamental principles

In discussing each recommended fundamental principle, the general scope of the fundamental principle is first explained with reference to the scope of the corresponding fundamental principle recommended in the regional and/or international frameworks. Thereafter, the discussion of each fundamental principle concludes by suggesting an alternative which, in my assessment, is fit-to-context for South Africa.

5.4.1 A single legal framework that regulates all secured transactions as far as possible

5.4.1.1 Analysis of the fundamental principle

The aim should, as far as practicable, be to adopt a single comprehensive secured transactions law framework for movable property.[56] This study has analysed different approaches that could potentially achieve the common goal of a single secured transactions law framework. To fulfil this fundamental principle, South Africa must adopt one of the three approaches identified: (1) a unitary approach which recharacterises all security devices as a security right (or interest) –

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54 Exactly when it will be regarded as 'prejudice' should be determined as part of the fundamental principles. For this section it is sufficient to recognise that the debtor must have a right of recourse to a court.

55 Either by public notice when an enforcement notice is registered in a registry, or individually delivered notices.

56 The purpose of recommendations 2-12 of the UNCITRAL Guide.

an option recommended by the UNCITRAL framework;[57] (2) an approach under which a uniform system does not recharacterise the traditional security devices, but provides that uniform legal rules apply to all the different security devices – the option recommended by the OAS Model Law;[58] or (3) a more formalistic commercially facilitative approach – the EBRD Model Law recommends a single security right in the form of a charge.[59] Approaches (1) and (2) are associated with incorporating a functional, integrated, and comprehensive approach.[60] The discussion below identifies the policy for and against each specific approach.

The meaning of a 'single secured transactions law framework' should be flexible in the sense that it would be possible to categorise most security devices uniformly (apply similar legal rules to all), but there might have to be policy-based exceptions providing that the uniform application of legal rules is possible only up to a certain point.[61] The ideal outcome is designated security devices which delineate which type of obligation (either static or dynamic) and under what categories of movable property can be accommodated by a specific security device. To introduce designated security devices in this way will result in similar legal rules applying to the same type of secured obligation and for equivalent categories of movable property. Consequently, a single legal framework should include security devices that can offer three specific functions: (1) a static form of security;[62] (2) a dynamic form of security;[63] and (3) a title-based form of security.[64]

(a) A unitary approach

The unitary approach involves the recharacterisation of all types of security device – including title-based security devices – as a single category: a generic 'security interest' (or 'security right').[65] Both the UNCITRAL Guide and the UNCITRAL Model Law recommend using the

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57 See Chapter 3 paragraph 3.3.3.2 *supra* and the recommendation to adopt a functional, integrated, and comprehensive approach.

58 See Chapter 4 paragraph 4.3.3.1 *supra.* Nevertheless, the non-unitary approach towards non-acquisition financing is arguably also a uniform system of rules.

59 It is not entirely correct that the EBRD Model Law follows a similar approach to the UNCITRAL Guide (*contra* to E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 241).

60 The functional approach is explained in Chapter 3 paragraph 3.3.3.2 *supra*.

61 One example is that the provisions of the legal framework will not apply to title-based security devices.

62 The assets and the secured obligation remain constant with this type of device.

63 The secured assets and secured obligation can fluctuate, provided that the fluctuation complies with specific legal rules.

64 These particular functions of security devices are explained further in the recommendation section in paragraph 5.4.1.2 *infra.*

65 See Chapter 1 paragraph 1.1.2 *supra* and Chapter 3 paragraph 3.5.1 *supra* for a general discussion of the content of the unitary approach.

unitary concept of a security right. However, solely as regards acquisition financing, the Guide distinguishes between using a unitary or a non-unitary approach (the UNCITRAL Model Law does not recommend this distinction).[66] As mentioned *supra*, introducing the non-unitary approach to acquisition finance as an alternative was an elaborate attempt at compromise but is potentially challenging to implement in practice.[67]

The pertinent question, then, is *why* a legislator would want to adopt a unitary approach. First, this unified approach would be easier to introduce as implementation would not require amendment of existing legal rules. One receives a 'clean-slate', so to speak, and the framework is removed from the existing property law to some extent, so as to create a legal framework based on commercial needs. This reasoning is problematic as the approach can be seen to disregard the historical basis of the domestic legal system – if not completely, at least in some respects. Bridge makes the valid point that the goal of the unitary approach behind UCC Article 9 was 'to detach entailments of security from conventional property analysis' in order to be able to resolve commercial disputes more easily.[68] This disregard of a country's historical context is tricky as the secured transactions law must operate in a broader legal system – eg, the laws of obligations, property, civil procedure, and insolvency– and a legally efficient reform should be 'fit-to-context'. Therefore, existing principles, policies, and rules cannot be disregarded. Also, the 'over-capture' of the kind of assets included in a secured transactions law framework would remove the advantages associated with having specific security devices fulfilling designated purposes.[69] An example is a framework which provides for the outright sale of receivables, which is not a security device in the traditional sense, but which provides enterprises with access to cash.

A second reason why a legislator might elect to adopt a unitary approach is the prospect of increased accessibility as all legal rules are contained in a single instrument. More importantly, however, the same principles in respect of publicity and specificity apply to all devices falling within the framework. Housing all legal rules in a single legal instrument cannot

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66 See the explanation of the distinction in Chapter 3 paragraphs 3.3.4.3 and 3.5.1 *supra*. Briefly, the Guide's non-unitary approach entails that retentions-of-title and financial leases are not recharacterised as acquisition security rights, but that the rules applicable to other acquisition security rights apply equally to a retention-of-title and a financial lease, as far as possible.

67 See Chapter 3 paragraph 3.5.1 *supra*.

68 MG Bridge *et al* 'Formalism, functionalism, and understanding the law of secured transactions' (1999) 44 *McGill LJ* 567 at 573.

69 MG Bridge *et al* 'Formalism, functionalism, and understanding the law of secured transactions' (1999) 44 *McGill LJ* 567 at 621-623. See also, M Bridge 'Secured credit legislation: functionalism or transactional co-existence' in SV Bazinas & NO Akseli (eds) *International and Comparative Secured Transactions Law: Essays in honour of Roderick A Macdonald* (2017) at 12-14.

be faulted as a general goal, but this ideal can also be achieved under either the uniform or the commercially facilitative approach, by introducing comprehensive legislation.

The third reason for adopting a unitary approach is that it supposedly results in the equal treatment of all types of creditor, which is particularly relevant in the case of title-based security devices. The unitary approach requires that a right (ownership) under a title-based security device be reclassified as a security right. However, to recategorise ownership as a security right (or interest) in the context of acquisition financing, effectively dilutes the nature of ownership (in particular, the indivisible concept of ownership known to civil-law traditions).[70] It is true that an acquisition security right – or a PMSI – can attain super-priority over other creditors which brings this right closer to ownership in substance. However, the super-priority of such a security right is not automatic because the secured creditor is still required to take additional steps to achieve the super-priority status.[71] In practical terms, if the acquisition secured creditor fails to take these additional steps, it will rank equally with any other secured creditor who has not effectively traded a reservation of ownership for a security right. Even more problematic, where the seller (effectively the owner of the collateral) fails to take any further steps, her unperfected security right would rank below any other perfected security right. Ultimately, a unitary approach can be seen to disregard the practical and legal reality that the seller is indeed the owner of the encumbered property until the buyer (debtor) fulfils the suspensive condition, which is generally the payment of the purchase price (or debt).

(b) The uniform application of specific legal rules

The uniform approach has been referred to as the 'temporary, partial solution' before adopting a comprehensive unitary approach.[72] Unlike the unitary approach, the uniform approach does not demand the recharacterisation of the distinct security devices as a single concept, since it permits the retention of the separate labels attached to traditional security devices. Instead, the idea is that the same uniform system of rules should apply to the distinct devices that form part of secured transactions law framework, provided that the traditional security devices meet the

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70 See NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 243 agreeing that the value of full ownership rights is reduced to a limited right.

71 See *supra* Chapter 3 paragraphs 3.3.4.6 (additional steps concerning third-party effectiveness), 3.3.4.7 (additional steps concerning priority), and 3.3.4.8 (additional steps concerning priority regards proceeds) *supra* discuss the additional measures in the UNCITRAL framework.

72 AH Raymond 'Cross-border secured transactions: ongoing issues and possible solutions' (2011) 87 *Elon Law Review* 87 at 99 with reference to this approach under the OAS Model Law.

requirements for qualifying as a security interest. Significantly, the uniform system of rules can apply to all or only some components – eg, the rules governing the creation of the security right may differ among security devices. Thus, the law might provide that a right in terms of a title-based security device can be created without registration,[73] while at the same time stipulate that the rules regarding enforcement are the same for all security rights and rights under title-based security devices.

The OAS Model Law, discussed in Chapter 4 *supra*, is an example of a framework that recommends applying uniform rules for the priority and enforcement of traditional security devices which meet the criteria of a security interest. Accordingly, the OAS Model Law uses a uniform system of rules applicable to all security devices as far as possible. This means that the separate labels of security devices remain intact, but where the devices meet the requirements for a security interest in article 2 of the Model Law, the same rules in respect of third-party effectiveness,[74] priority, and enforcement apply across the board to all security devices.[75]

The alternative option of applying uniform legal rules to both security rights and rights under title-based security devices as functional equivalents, presents particular challenges and is potentially also an elaborate attempt at compromise. Where a title-based security device is the functional equivalent of a security right, it is certainly advisable that the respective frameworks – for security rights and *quasi*-security rights – should move closer to each other in substance. However, ownership is typically a stronger right than a security right. If a unitary system of legal rules is adopted, it would appear unavoidable that the strength of the ownership right would have to be diluted for it to move closer in essence to a security right.[76] Also, the uniform rules in respect of third-party effectiveness require that all security interests, excluding possessory security interests, must be registered to become effective against third parties.[77] Therefore, a retention-of-title would not be effective against a third party unless it was registered. Adopting this approach would amount to a departure from the general rule in terms of which a retention-of-title is created and becomes effective against third parties upon the conclusion of the security contract. It also contradicts the approaches taken by other civil-law

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73 This is the approach under the Belgian Pledge Act of 11 July 2013. See E Dirix 'The new Belgian Act on security interests in movable property' (2014) 23 *Int Insolv Rev* 171 at 178.

74 An important consideration is whether the priority of a possessory security interest depends on the date of registration or the date of transfer of possession.

75 See *supra* Chapter 4 paragraphs 4.3.3.1 and 4.4.1.

76 Similar to the issue identified above as regards to the unitary approach in paragraph 5.4.1.1(*a*) *supra*.

77 There is room to interpret that a possessory pledge should be registered to determine its priority as the OAS Model Law has a unitary and uniform registration system which applies to all security rights.

traditions in their reform projects where a retention-of-title does not have to be registered to be effective against third parties.[78]

Again, the question is *why* a legislator would want to implement a uniform system. Where all the components of the framework involve uniform rules, despite keeping the separate labels of the security devices, all devices are treated the same. Thus, on face value, a uniform system amounts to the same approach as using the unitary concept of a security interest (or right). However, the value of the uniform approach lies in adopting uniform rules as far as possible, but allowing divergence between the rules when there is a sound policy reason for doing so (eg, excluding uniform rules in respect of creation). Essentially, the uniform system also underpins the operation of the Cape Town Convention.[79] In this regard, uniform rules apply to an international interest under the Convention, but a domestic right that fits within the definition of either a security agreement, a title reservation agreement, or a leasing agreement, as defined in the Convention, may qualify as an international interest.[80] There is, therefore, no reason to recharacterise the domestic security device.

The uniform approach also holds the benefits that: (1) stakeholders can continue to use security devices that are familiar to them; and (2) the reformers would, it is hoped, have investigated the rules applicable to the individual security devices and improved them where necessary. Nevertheless, the non-unitary approach might amount to an intricate concession that can create mismatches between old and new rules applicable to a specific a security device. Also, not all security devices should be subjected to the same rules as this may undermine the commercial advantages associated with a specific security device.

(c) Commercially facilitative approach

The preferred approach is to introduce a legal framework which enables commerce to operate effectively, but which also reflects unity, as far as possible, between the legal principles applicable to different security devices. For instance, the EBRD Model Law follows a formal yet commercially facilitative approach.[81] This approach relies on the concept of having a

78 This is the position under the Belgian Pledge Act of 11 July 2013 (art 58).

79 See the discussion of the Cape Town Convention in Chapter 3 paragraph 3.2.1 *supra*.

80 Article 2(2) of the Cape Town Convention sets out this general approach and the three types of agreement are defined in art 1(*ii*) (security agreement), art 1(*ll*) (title reservation agreement) and art 1(*q*) (leasing agreement).

81 I have coined the term 'commercially facilitative' to describe a formal legal framework that allows commerce to function effectively.

'single security right'. The EBRD Model Law categorises all security rights as one of four types of charge, each with a specific purpose.[82] The difference in the legal rules applicable to the respective charges results, in some instances, from the divergent nature and use of each charge.[83]

Practically, introducing this single security right as part of a legal framework similar to the EBRD Model Law would have specific consequences.[84] First, the framework essentially applies to all types of property and secured obligations – its scope is comprehensive.[85] Second, the framework contains general provisions that should apply to all security devices.[86] However, the divergence or similarity between the legal rules that should apply to the creation, third-party effectiveness, priority, and enforcement should depend on the designated structure and the ultimate purpose that a particular charge fulfils.

A modern secured transactions law framework needs to be able to accommodate both a security right in the traditional sense, and a title-based security device – albeit as separate components of a single framework. One could interpret the UNCITRAL Guide as acknowledging what was stated *supra*, namely, that it may not be desirable to recharacterise title-based rights as a security right when the framework suggests using a non-unitary approach to acquisition financing.[87] A distinguishing factor of a commercially facilitative framework is that it includes designated security devices which fulfil a specific function (or purpose). Accordingly, a commercially facilitative framework should include one security device suited to function as a static security device; another which functions as a dynamic security device; or one which combines the static and dynamic characteristics as part of a single security device; and finally, a security device which uses ownership to secure the performance of an obligation.[88] 'Dynamic' does not mean that the security right would 'float', but rather that the registered right exists in the pool of encumbered assets at a given time, subject to provisions

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82 The charges are the possessory charge (the functional equivalent of a possessory pledge), the registered charge, the enterprise charge (a floating security device), and the unpaid vendor's charge (the functional equivalent of retention-of-title device).

83 See Chapter 4 paragraph 4.4.3.2(*a*) *supra* for a general discussion of all four charges and paragraph 4.4.3.2(*i*) where the enterprise charge is discussed.

84 Röver states these as consequences of introducing a single security right under the EBRD Model Law. See J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 76.

85 The flexibility of the EBRD Model Law arises from the flexible definitions of the charged property and the secured obligation.

86 This could be the principles and ground rules that form part of the framework.

87 See Chapter 3 paragraph 3.3.4.3(*b*) *supra*.

88 Arguably, the encumbered property and the secured obligation are described in flexible terms it will be possible to introduce a dynamic security device.

governing certain categories of encumbered asset which can be released from the secured pool of assets – eg, inventory.[89]

In my assessment, a future South African reform project should follow a commercially facilitative approach similar, in some respects, to the EBRD Model Law.

5.4.1.2 Recommendation for reforming the South African framework

I recommend that the reformed South African framework should follow a commercially facilitative approach. This section explains why a reformed South African framework should not include a unitary approach.[90] I also clarify how a commercially facilitative approach should be incorporated as part of a reformed South African framework. Finally, I offer specific recommendations as to the structure of security devices that should form part of a reformed South African framework. The implementation of these recommendations should ultimately result, as far as possible, in a single, commercially facilitative legal framework for South Africa.

(a) The recommendation against adopting a unitary approach

In my assessment, the apparent benefits associated with a unitary approach are not sufficient to recommend that the South African real security law framework be amended to follow a unitary approach. Accordingly, as recommended by the Scottish Law Commission, the unitary approach, along with the recharacterisation of the current security devices, is not advised.[91] Furthermore, implementing uniform legal rules could work in certain respects, but following the OAS Model Law's exact approach is not the most straightforward solution to reforming the South African framework.[92] Title-based security devices should preferably not be equated with a security right. Effectively, equating a reservation of ownership with a security right removes the autonomy parties enjoy in deciding which specific security device will best allow them to benefit from the advantages associated with using that particular device.

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89 Paragraph 5.4.1.2 *infra* recommends how this distinguishing factor should be incorporated as part of the reformed South African framework.

90 This discussion merely adds to the general criticism of the two approaches above.

91 The Scottish Law Commission 'Report on Moveable Transactions: Volume 2: Security over Moveable Property' December 2017 (Scottish Law Commission 2017 (2) report) para 16.31 available at https://www.scotlawcom.gov.uk/files/9215/1361/1360/Report_on_Moveable_Transactions_-_Volume_2_Report_249.pdf (date of access: 5 March 2018).

92 The OAS Model Law approach appears contradictory at times.

The South African reform project should ideally take place through incremental changes. This implies that functionalism should be applied as far as possible –using the standards of the soft-law instruments as a benchmark – but a non-unitary approach is recommended to retain the advantages associated with using a specific security device. The success of any law reform process depends largely on the practical question – Can the recommended legal framework be 'sold' to the sector's stakeholders? The reality is that a complete recharacterisation of the current security devices into a single unitary concept will in all likelihood prove a difficult sell to the South African credit industry that has used the existing framework for close on three decades. Thus, the recommended approach, for the present at least, is a commercially facilitative approach. The details of the intended commercially facilitative framework are discussed next.

(b) A commercially facilitative approach to reforming the South African system: primary considerations

A commercially facilitative framework should be comprehensive – discussed separately as a fundamental principle *infra.*[93] Furthermore, a secured transactions law framework should make it possible for a creditor to mitigate the risks associated with advancing credit. This risk-mitigating feature is, in the main, achieved when the framework has clear publicity rules. Moreover, a legal framework should provide commerce with the functional equivalents of: (1) a comprehensive non-possessory security device which includes being able to function as a dynamic security device, and specific categories of incorporeal movable property; and (2) a security device which allows the use of reservation-of-ownership, but avoids secret security rights, and guards against the debtor suffering unfair consequences as a result of the creditor using a reservation-of-ownership. The recommendation contained in this section will only address the types of security device that should form part of the reformed South African framework.

The questions are: (1) *what does South Africa require* for the existing framework to become *commercially facilitative;* and (2) *what is the simplest way* to create an effective framework, but with due consideration of the South African legal, political, and social contexts? This means that a decision must be made on: (1) *what must remain*; (2) *what must be*

93 See *infra* paragraphs 5.4.2.1 (the general meaning of a comprehensive approach) and 5.4.2.2 (the nature of a comprehensive scope which coincides with the recommended commercially facilitative approach).

removed; and/or (3) *what can be changed in the existing framework* so that commerce can benefit from using the amended legal framework. In my view, the solution lies in adding a comprehensive security device while removing some of the existing devices. Therefore, I recommend that instead of developing an entirely new framework from scratch, the preferred approach, for the present, should be first to correct the flaws in the current framework.[94] The most pertinent issues to address in the current South African framework concern: (1) the scope of the framework;[95] (2) the required level of transparency – whether a strict specificity principle and a cumbersome registration process are really required; and (3) how swiftly the security can be enforced.[96]

The first recommendation is to create a registered pledge.[97] The second recommendation, which differs from the EBRD Model Law's approach, is to retain the current title-based security devices known to South Africa in their current form, again, at least for now, while amending those rules that result in unfair outcomes for the debtor. The next recommendation concerns the voluntary registration of security created under certain security devices without the registration having an effect on the third-party effectiveness. Instead, one could consider establishing a rule in terms of which registration influences the *priority* ranking of specific security rights – eg, the registration of possessory pledges.

(c) A commercially facilitative approach: a registered non-possessory pledge

The term 'statutory pledge' is not preferred as it could be confused with existing statutory pledges created by operation of law.[98] Therefore, the preferred name is a 'registered pledge'. The primary considerations regarding the recommended registered pledge include whether it is feasible for this pledge to be both a dynamic and a static security device, and how comprehensive the scope of this registered pledge should be.[99] In fact, these considerations are

94 This means that a commercially facilitative approach is the recommendation for the present, but the possibility of reforming the South African framework using a unitary approach in the future should not excluded.

95 The scope is broadened by introducing a more comprehensive security device (a registered pledge) and also adopting the recommendations in paragraph 5.4.2 *infra* regarding the assets that should form part of the framework.

96 See the recommendations in paragraph 5.4.7 *infra.*

97 Entailing a static security device only, or both a static and dynamic security device.

98 The Scottish Law Commission recommended the term 'statutory pledge'. The reason 'registered pledge' was not used as the statutory rules imposed by the European Union concerning financial collateral results that it is not possible to insist on registration for specific types of properties. See the Scottish Law Commission 2017 (2) report at 36.

99 The meaning of 'scope' addresses which movable property can be taken as collateral and which secured obligation can be secured by the registered pledge.

co-dependent as it is not possible to have a dynamic security device without a sufficiently comprehensive scope.

The issues with the current 'fixed-type security' – the special notarial bond under the SMPA – were pointed out in Chapter 2, *supra*.[100] Moreover, the issues associated with using a general notarial bond, the current 'dynamic type' of security available in South Africa, include that: (1) one cannot use the general notarial bond to single-out an 'economic entity'– eg, stock-in-trade – because the bond should be registered in respect of literally *all* of the debtor's movable assets, so raising the possibility of over-collateralisation;[101] (2) the registration process is cumbersome and costly; and (3) the security must be perfected through transfer of possession of the collateral to the secured creditor, even though the unperfected security gives the creditor a preferential right over other concurrent creditors on the debtor's insolvency.[102] In light of these deficiencies, the recommendation is to replace notarial bonds completely. Thus, the notarial and deeds office process should be done away with and replaced by a user-friendly registry dealing exclusively with movable property. The proposed registration method is discussed separately *infra*.[103]

The creditor under a registered pledge should be able to take the following movable property as security: (1) any kind of corporeal movable property – unless expressly excluded for policy reasons;[104] (2) future assets; and (3) virtually any kind of incorporeal movable property, such as intellectual property,[105] financial instruments (eg, shares), and claims (receivables).[106] However, the registered pledge should, at least for the present, have a restricted application to claims until the uncertainties surrounding cession *in securitatem debiti* has been resolved. Therefore, as regards claims, it should be possible to register a pledge of personal rights.[107] But, where the creditor elects to create what could be described as akin to a

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100 See Chapter 2 paragraphs 2.5.4.1, 2.5.4.3, 2.5.6, 2.5.9, 2.7.2 and 2.7.3 *supra*.

101 According to Bridge, there are two risks to a debtor which a modern secured transactions law framework must guard against: over-collateralisation; and overly broad enforcement rights in favour of the secured creditor. See M Bridge 'Secured credit legislation: functionalism or transactional co-existence' in SV Bazinas & NO Akseli (eds) *International and Comparative Secured Transactions Law: Essays in honour of Roderick A Macdonald* (2017) at 3.

102 Section 102 of the Insolvency Act.

103 See paragraph 5.4.4 *infra*.

104 The categories of corporeal movable property should include future assets, either all the debtor's assets or only an economic entity (eg, stock-in-trade) and the types of asset discussed further in paragraph 5.4.2, *infra* relating to the comprehensive scope of the framework.

105 This would include the intellectual property itself and applications for or a licence in intellectual property.

106 A claim would relate to the personal right a creditor has to demand payment from its debtor. See R Brits *Real Security Law* (2016) at 273.

107 See the distinction in Chapter 2 paragraph 2.4.6 *supra* between an out-and-out security cession (also referred to as a fiduciary security cession) and a pledge of personal rights (the pledge construction).

limited real right in the personal right[108] using cession *in securitatem debiti*, that right should also be registered. Registration, however, should not influence the moment at which the real right is created. The registration of the cession *in securitatem debiti* merely determines the priority ranking of the right in terms of this cession. Conversely, I recommend that an out-and-out security cession may be registered on a voluntary basis, but without any legal consequences attaching to this registration.[109]

If the scope of the registered pledge is correctly designed, it is possible for the pledge to be both a static and a dynamic security. The registered pledge would then be a hybrid security device, meaning that it would have both a static and a dynamic character – depending on the parties' intentions. Röver explains the characteristics of a security device that would be able to extend to a changing pool of assets – ie, a fully dynamic security right.[110] The characteristics specifically relevant to the dynamic security device I recommend for South Africa, should include the following: (1) the possibility of taking multiple assets as security;[111] (2) it should cover future movable property; (3) the security right in future property should be accorded the same priority as a security over existing property taken at the same time; (4) the person granting the security should be able to use and dispose of the secured property;[112] and (5) the property and the secured obligation should be described generally.[113] Thus, whether the registered pledge will be a dynamic security device depends on the extent to which the security device complies with these characteristics. In effect, this would require that the framework have a comprehensive scope – an aspect discussed as a separate fundamental principle *infra.* [114]

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108 See the practical, albeit fictional, explanation of a secured transaction using personal rights as security in Chapter 2 paragraph 2.4.6 *supra*.

109 There is a risk that parties may decide rather to use an out-an-out cession to avoid having to register the cession. Nevertheless, it is unlikely that a debtor would agree to this. Further, other recently reformed secured transactions law frameworks elected to remove the registration of out-an-out cession from the secured transactions law framework (eg, the removal from the Belgian Pledge Act of 11 July 2013).

110 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 164.

111 This would include an economic entity or all the debtor's assets. This is discussed further in paragraph 5.4.2 *infra*.

112 Arguably, this should also include that the debtor should be able to sell inventory sold in the ordinary course of her business, free from encumbrances, or it should also be possible, per agreement between the parties, to release a portion of the asset(s) if the debt is reduced.

113 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 164. The other requirements listed by Röver, but not relevant to the South African reform, include: (1) that a security right can be created irrespective of whether or not collateral is situated inside or outside the jurisdiction of creation; and (2) that there should be no general provisions on fraudulent conveyancing in insolvency.

114 See paragraph 5.4.2.2 *infra*.

Even though the general notarial bond is registered, the right under this bond remains a personal right until the security has been perfected by possession. Accordingly, the creditor's right only vests in the bonded property once perfection takes place.[115] This necessarily entails the potential to weaken the quality of the creditor's security.[116] Conversely, a dynamic-type registered pledge vests in the debtor's assets when registration takes place and the real security right exists in the debtor's assets at any given time. Thus, there need to be specific legal rules that allow the debtor to replace specific categories of assets in specific instances. These special rules could relate to the following: (1) allowing that *inventory* to be sold free from the encumbrances, provided that it is sold in the ordinary course of the debtor's business; (2) including the possibility of taking a security right in an economic entity – eg, the debtor's stock-in-trade; (3) including the right to substitution of assets; (4) stipulating a percentage of the number of certain types of assets may fluctuate during the loan period; and/or (5) requiring that the security right extend to the proceeds and the mass or product resulting from the original encumbered asset.[117]

In the case of designing a generic registered pledge which can be both static and dynamic, one disadvantage is that an all-asset type security leaves nothing for unsecured creditors. Another disadvantage is that an all-asset type security could create a monopoly in favour of a single creditor, resulting in over-collateralisation in her favour. This nowithstanding, adopting a hybrid security device still allows the debtor to choose whether to provide only a portion of her assets as security in the form of an economic entity, essentially resolving the issue of over-collaterisation in favour of a single creditor.

(d) A commercially facilitative approach: possessory pledges

The possessory pledge proposed for a reformed South African secured transactions law should include not only the possessory pledge in the traditional sense, but also cession *in securitatem debiti* – a pledge of claims. The classification of a cession *in securitatem debiti* as a possessory pledge should, however, be limited to the transactions designed in accordance with the pledge construction of cession.[118] The possessory pledge in its current form can remain part of the

115 Essentially the debtor's assets could change until perfection.

116 See the discussion of the legal nature of a general bond in Chapter 2 paragraph 2.5.2(*a*) *supra*.

117 Where the debtor is allowed to sell inventory in the ordinary course of her business free from encumbrances, the creditor must be able to lay claim to the proceeds from that sale.

118 This entails that a claim can be included under the registered pledge, but that it remains possible to take cession of a claim subject to registration to determine the priority ranking of the right.

legal framework. As attornment is already recognised as a delivery method to constitute a possessory pledge, the current South African framework contains no restrictions regarding 'warehousing'. Also, the legal rules concerning cession for security purposes should remain – eg, the general rule that there is no need to notify the debtor of the cession of her debts.

South Africa should consider investigating the option of establishing a mechanism to register the security rights created under both a traditional pledge and a cession for security purposes (the pledge construction). In such a system, the possessory pledge would still be created with *erga omnes* enforceability when possession or control is transferred to the creditor via delivery or cession, but it should be considered whether the priority ranking of the resulting security right should be determined with reference to the date of registration of the possessory pledge in the general registry.

(e) A commercially facilitative approach: title-based security devices

The title-based security devices known to South African law are divided between: (1) reservation of ownership – eg, instalment agreements and retention-of-title;[119] and (2) security transfer of ownership. Currently, only out-and-out cession of incorporeal assets is recognised under South African law as a valid security transfer of ownership. Security transfer of ownership of corporeal movable property owned by the debtor is generally classified as a simulated transaction, and as such is not upheld by the courts. This is because the law does not recognise the substance of this transaction (transfer of ownership for security) but rather the form (a non-possessory, and so ineffective, pledge).[120]

For purposes of this study, I make three main recommendations with regard to the treatment of title-based security devices in any future reform initiative. First, the general recommendation is that the nature of the ownership right should not be diluted to equate it with a security right. Therefore, the current categories should remain intact, but serious consideration should be given to the recognition in law of the security transfer of ownership for corporeal movable property as well, subject, however, to a publicity requirement. The second recommendation is to allow the parties to register their rights under instalment agreements and retentions-of-title in a public registry – an option of voluntary registration to

119 It is not entirely certain whether the lease under the NCA should qualify as a title-based security device.
120 See the discussion of simulated transactions in Chapter 2 paragraph 2.6.1.1 *supra*.

improve transparency.[121] The final recommendation is to amend certain enforcement measures for title-based security devices which potentially result in unfair consequences for debtors. Firstly, where a title-based device allows for the forfeiture of the encumbered property, the seller effectively remains the owner of the property until the buyer has paid the full purchase price. This means that if the buyer defaults, the seller can sell the property without regard to its value or the extent of the outstanding debt.[122] Secondly, the enforcement measures available in the event of *seller* becoming insolvent should also be amended to allow a fair outcome for, in particular, the buyer who has already paid a substantial portion of the purchase price. Each recommendation is discussed briefly *infra*.

With regard to the first recommendation, in my view, there is no reason to classify the rights under retention-of-title and instalment agreements as real security rights. Instalment agreements appear to be working well for financial institutions, save for: (1) the lack of transparency (hence the recommendation of voluntary registration); (2) the unfair position of the buyer in the case of the seller's insolvency (the asset falls in the estate of the seller); and (3) the uncertainty surrounding whether multiple assets and revolving assets can form the subject of an instalment agreement.[123] Registration should not affect priority, as ownership is indivisible, and the only purpose of registration in this context is to protect third parties by notifying them of the reservation of ownership. If a movable property registry is established as recommended *infra*,[124] the cost of registration should be minimal. In any event, the benefits of registration will far outweigh its cost.

The second recommendation relates to the unfair position of the buyer when a right under an instalment agreement or retention-of-title is enforced. A distinction is currently made between a defaulting *solvent* debtor and a defaulting *insolvent* debtor under an instalment agreement and retention-of-title. In the case of a defaulting solvent debtor under an instalment agreement (not subject to the NCA)[125] and a retention-of-title, the seller (creditor) may sell the asset and is under no obligation to account for any surplus (the difference between the purchase

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121 As it is currently not a requirement to register title-based devices, it is recommended that registration be introduced incrementally. Hence, the recommendation is to first introduce a voluntary registration option. The cost associated with this voluntary registration will influence whether creditors decide to use this type of registration.

122 This cannot happen with a real security as there is a prohibition on a *pactum commissorium.*

123 Practically, a financial institution would sign a Master Agreement where more than one asset was subject to an instalment agreement, but a separate addendum would be signed in respect of each separate asset.

124 See paragraph 5.4.4.2 *infra.*

125 Section 127 of the NCA protects the consumer against this unfair outcome and even more, the debtor would have to approve the value of the asset being sold.

price fetched and the outstanding amount) to the debtor. This unjustifiable enrichment of the seller can be counteracted by requiring her to refund any surplus value to the buyer.[126] As regards the defaulting *insolvent* debtor, section 84 of the Insolvency Act could apply. This section provides that when the debtor becomes insolvent, the seller effectively trades her reservation of ownership for a security right in the movable property while the asset forms part of the buyer's insolvent estate. However, if the seller becomes insolvent, the trustee of the seller's estate may decide whether or not the instalment agreement continues. The trustee has no obligation to consider the purchase price already paid by the buyer (even where the amount is substantial). The trustee of the seller's insolvent estate could effectively repossess the hypothecated movable property, leaving the buyer with a concurrent claim against the insolvent estate for the instalments already paid. This position is perhaps not substantially unfair when the debtor had only recenty started paying instalments. The prejudice comes in where the debtor had already paid a substantial portion of the purchase price. Consequently, where the buyer has already paid a substantial portion of the purchase price, my recommendation is that the trustee give the buyer an option to pay the remainder of the purchase price so that ownership in the movable property can pass from the seller's insolvent estate to the buyer.[127]

The implementation of these recommendations depends largely on extending the scope of the South African legal framework to include certain assets for which there is currently insufficient or no provision. This raises the fundamental principle regarding how comprehensive the framework should be, and it is to this that we now turn.

5.4.2 A framework with a comprehensive scope, allowing the debtor to use most types of assets to secure any obligation in respect of any category of secured transaction

It is impossible to introduce a single legal framework of the type recommended above, without also including the fundamental principle discussed under this head, and *vice versa*. Realising this fundamental principle depends on the nature of the security devices included under the framework; establishing a framework with a comprehensive scope would make it possible to use a specific security device – eg, allowing a registered pledge that is both dynamic *and* static in nature. Adopting a comprehensive framework may challenge the notion of a 'closed list' of

126 This was also the suggestion under art 72 of the Belgian Pledge Act of 11 July 2013. See also, E Dirix 'The new Belgian Act on security interests in movable property' (2014) 23 *Int Insolv Rev* 171 at 179.

127 The issues concerning enforcement are discussed in paragraph 5.4.6 *infra.*

real rights – ie, the *numerus clausus* doctrine,[128] and correctly so. Provided that the purpose behind this doctrine – to establish an acceptable level of predictability and certainty – is achieved, there is no reason why a modern legal framework should not depart from the application of the *numerus clausus* doctrine.

5.4.2.1 Analysis of the fundamental principle

The analysis in this section is directed at: (1) the types and/or categories of movable property that may be encumbered; (2) the degree to which the specificity principle influences the scope of the framework;[129] (3) the extent to which the security right should extend to future assets, proceeds, a mass, a product, and fixtures attached to immovable property; and (4) the nature of the secured obligations that should be accommodated by the framework.

(a) Excluding or including certain assets

The types of asset that can be included under a modern secured transactions law framework should be as broad as legally and practically possible. The assumption is that any movable property, either corporeal or incorporeal, can be included in the framework, unless a type of asset is excluded from the framework for a specific policy reason. Also, it should be possible to take a security right in a part of a movable asset or an undivided right in an asset.

Two of the legal frameworks analysed in this thesis, the UNCITRAL framework and the OAS Model Law,[130] correspond closely with regard to the kinds of asset that should be excluded from a framework. Excluded assets are: (1) mobile equipment subject to specialised international or domestic legislation – eg, aircraft and ships; (2) payment rights arising from either financial contracts governed by netting agreements, or foreign exchange transactions; (3) intermediated securities – eg, shares held in a trading account;[131] and (4) consumer goods.[132]

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128 The doctrine is discussed in Chapter 2 paragraph 2.3.3.2 *supra*. This doctrine does not apply in South African law.

129 Specificity means how detailed the description of the encumbered asset (and in some legal frameworks the secured obligation) should be according to the law.

130 The EBRD Model Law does not include a recommendation on the kinds of movable asset that should be included in a framework, and the decision on which assets to include is left to the adopting country.

131 The approach in the frameworks analysed differs in this respect. For example, the UNCITRAL Model Law includes intermediated securities, while the UNCITRAL Guide recommends that both intermediated and non-intermediated securities should be excluded.

132 None of the legal frameworks extends their scope directly to consumer goods, although the EBRD Model Law mentions the possibility of inclusion where a country has adequate consumer protection laws in place.

The most prominent types of incorporeal movable property included under both the UNCITRAL framework and the OAS Model Law are intellectual property,[133] receivables (but some types of receivable are excluded),[134] the right to payment of funds credited to a bank account, and particular securities (eg, shares).[135] Non-intermediated securities are directly held with the issuer, whereas intermediated securities are securities credited to a securities account maintained by an intermediated.[136] The UNCITRAL Guide recommends excluding both intermediated and non-intermediated securities.[137] The UNCITRAL Model Law, on the other hand, only recommends excluding intermediated securities, as non-intermediated securities are not as regulated as intermediated securities and are often used as security for a secured transaction.[138]

(b) Application of the specificity principle to assets that can be included under the framework

The application of the specificity principle creates a potential trade-off between the legal framework's flexibility and its legal certainty. A modern secured transactions law framework places greater emphasis on the flexibility of the framework than on absolute certainty of what particular assets are encumbered. Indeed, the modern specificity standard appears to be less concerned with what is *identified*, and more with what is *identifiable*.[139] Therefore, the modern application of the specificity principle relates to a sufficient degree of certainty resulting from

133 But only to the extent that it is not inconsistent with either the national laws of a country or other treaty obligations. Thus, the general recommendation is that further investigation needs to be undertaken to see how a secured transactions law framework is inconsistent with intellectual property law.

134 A receivable is the right a person has to the payment of a monetary obligation. The UNCITRAL framework (see Chapter 3 paragraph 3.3.3.1(*b*) *supra*) and the OAS Model Law (see Chapter 4 paragraph 4.3.3.2(*a*) *supra*) mentions receivables specifically and includes: (1) contractual and non-contractual receivables; and (2) outright sale of receivables and receivables used to secure a loan. Excluded rights of payments that fall outside of the meaning of a receivable will be: (1) the right to payment evidenced by a negotiable instrument; (2) a right to payment of funds credited to a bank account; and (3) the right to payment under a non-intermediated security. See art 2(*dd*) of the UNCITRAL Model Law.

135 The frameworks arguably also relate to other incorporeal movable property, but a discussion of these categories is sufficient for this thesis.

136 Non-intermediated securities are those securities *not* 'credited to a securities account and rights in securities resulting from the credit of securities to a securities account'. See art 2(*w*) of the UNCITRAL Model Law.

137 However, the reasons for including non-intermediated securities are practically sound. See RM Kohn 'The case for including directly held securities within the scope of the UNCITRAL Legislative Guide on Secured Transactions' (2010) 15 *Unif L Rev* 413 at 413-418.

138 See Chapter 3 paragraph 3.3.3.1(*a*) *supra*.

139 See F Helsen 'Security in movables revisited: Belgium's rethinking of the Article 9 UCC system' (2015) 6 *Eur Rev Priv Law* 959 at 979 and the Belgian approach of favouring flexibility above specificity, which also corresponds to the UCC Article 9 approach.

the description in the security agreement and the registered notice regarding: (1) the encumbered property; and (2) the exact nature of the secured obligation.[140]

An overly strict specificity standard might provide absolute certainty regarding what property is covered by the security device, but this description inhibits the flexibility of the legal framework by excluding certain types of asset for which the commercial world requires a security device – eg, future assets, proceeds, and revolving assets.[141] A compromise is to adopt a specificity standard situated on a continuum somewhere between, on the one hand, a 'super-generic' description, and, on the other hand, the strict application of specificity.[142] The frameworks we have considered, typically state that the standard of identification should be either: (1) a general standard which requires describing the encumbered property and secured obligation either specifically or generally (eg, the EBRD Model Law and the OAS Model Law);[143] and/or (2) a standard which reasonably allows identification of the assets and secured obligations. The UNCITRAL Guide recommends that a standard *that reasonably allows their identification* should relate exclusively to the encumbered asset, but I prefer the approach of the UNCITRAL Model Law under which the standard applies both to the encumbered asset and the secured obligation (the latter is discussed under a separate heading *infra*).[144]

In my analysis, the preferred position is that the encumbered property should be described by a general standard to allow the reasonable identification of the asset, but that this description standard should also imply that the asset may be described generally or specifically. Furthermore, the unique circumstances of each secured transaction should determine what constitutes 'reasonable identification'. For example, when dealing with a high-value asset such as a motor vehicle, the asset should be identified using an alpha-numeric code. Conversely, when dealing with a revolving facility secured by stock-in-trade, a more general (or generic) asset description would be both adequate and appropriate, considering the revolving nature of the asset and the purpose of a revolving facility. Also, where the security covers all the debtor's current and future assets, the description literally includes everything owned by the debtor, and

140 The description standard should be the same for a filed notice and the security agreement.
141 See the discussion of this as an issue associated with South African special notarial bonds in Chapter 2 paragraph 2.5.4.2 *supra*.
142 F Helsen 'Security in movables revisited: Belgium's rethinking of the Article 9 UCC system' (2015) 6 *Eur Rev Priv Law* 959 at 982.
143 See *supra* Chapter 4 paragraphs 4.2.3.2(*a*) and 4.3.3.2 (*a*).
144 See Chapter 3 paragraph 3.3.3.1(*d*) *supra*.

it should be unnecessary to describe each individual asset specifically.[145] Consequently, whether a particular form of identification amounts to reasonable identification, depends on the nature of the securing asset and the commercial context of the transaction itself. In my view, the standard for determining whether there is reasonable identification of the asset, is that the description should be self-sufficient – the encumbered asset can be identified without any extrinsic evidence.

The application of the specificity principle influences both the categories of asset that can be included as collateral under the legal framework (discussed next), and the design of the general registry, discussed in 5.4.4 *infra*.

(c) Application to future assets, proceeds, a mass, a product, and fixtures to immovable property

All the frameworks discussed in Chapters 3 and 4 *supra*, recommend extending the scope of a secured transactions law framework to future assets.[146] Therefore, it appears uncontested that a modern secured transactions law framework should extend to future assets, especially if the security device is to be dynamic as discussed *supra*.[147] Two traditional property law ground rules potentially impact on extending the secured transactions law framework to future assets: (1) the *nemo plus iuris transferre potest quam ipse habet* rule (you cannot transfer more rights than you hold); and (2) the *priore tempore potior iure* rule (a right created first in time is first in law).[148] In theory, the *nemo plus iuris* rule is not contravened under the frameworks analysed because the security rights are created and will have third-party effect as soon as the future asset comes into existence. However, in the case of a future asset, the frameworks afford the secured creditor the required protection by allowing the retrospective application of the priority ranking,[149] which potentially impacts on the *prior tempore* rule. In any event, despite the dogmatic objections that may be raised against burdening future assets, it appears that all global

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145 According to art 9(2) of the UNCITRAL Model Law, a generic description referring to either all the debtor's assets or all the debtor's assets in a specific category (thus an economic entity) would meet the standard of that which 'reasonably allows their identification'.

146 See *supra*,the UNCITRAL framework in Chapter 3 paragraph 3.3.3.3; the World Bank's Doing Business report '*Doing Business* legal rights index' discussed in Chapter 3 paragraph 3.4.3; and the OAS Model Law Chapter 4 paragraph 4.3.3.2(*a*) *supra*.

147 See paragraph 5.5.1.3(*c*) *supra*.

148 The meaning of the rules is explained in Chapter 2 paragraphs 2.3.3.3(*b*) and (*c*) *supra*.

149 This means that even though the security right is created only as soon as the future asset exists, the priority ranking of this security right is determined with reference to an earlier registration date (a date before the security right existed).

and regional frameworks acknowledge the commercial need for such transactions, and one can therefore claim general consensus in this regard. Moreover, where the encumbered asset is described in the registered notice as 'all present and future movable property', this description is wide enough to include proceeds. However, where the registered notice does not include all the debtor's property, determining whether the security right extends to certain proceeds may be more complex, as discussed next.

The creditor's guarantee of receiving payment is locked in the encumbered asset, and where this asset is disposed of or transferred, the legal function of a secured transactions law framework dictates that the creditor should have recourse to the proceeds (or 'attributable property' under the OAS Model Law).[150] The EBRD Model Law contains a more general description of a right or a thing 'attached or related to the charged property', but adds that the attached or related thing or right is 'included with the charged property by operation of law'.[151] The UNCITRAL instruments recommend that the security right automatically extends to identifiable proceeds: (1) where the proceeds are described in the notice initially filed for the security right in the encumbered asset; (2) where the proceeds are in 'the form of money, receivables, negotiable instruments, or rights to payment of funds credited to a bank account', in which case the proceeds need not be described in the original notice; or (3) where options (1) and (2) do not apply, there should be a grace period during which the security right will automatically extend to proceeds, and the creditor can then file a separate notice in respect of the proceeds for the third-party effectiveness to continue after the grace period ends.[152] Conversely, in terms of the OAS Model Law, the security interest can only extend to the attributable property where this is mentioned as a possible consequence in the registration form for the original collateral.[153]

In considering whether the security right should automatically extend to the proceeds, the competing interests of: (1) the secured creditor who has lost her security; and (2) the innocent third party who has acquired the encumbered asset, should inform the content of the legal rule. The UNCITRAL Model Law provides the most extensive application of how far the secured creditor will be able to trace proceeds arising from the encumbered asset. Under the

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150 See *supra* Chapter 3 paragraph 3.3.3.1(*c*) (UNCITRAL instruments) and Chapter 4 paragraph 4.3.3.2(*a*) (OAS Model Law).

151 Chapter 4 paragraph 4.2.3.2(*a*) *supra*. Article 5.10 also refers to the charge automatically extending to insurance proceeds.

152 This would be temporary perfection, permitted when a security right may not be discoverable on the registry for a short period. See HC Sigman 'Perfection and priority of security rights' (2008) 5 *ECFR* 143 at 150.

153 Chapter 4 paragraph 4.3.3.2(*a*) *supra*.

UNCITRAL Model Law, proceeds include those received by a transferee (a person who acquired an asset subject to an existing security interest).[154] The choice on how far the meaning of 'proceeds' should extend, is ultimately a policy choice between protecting: (1) the secured creditor's right to have the debt settled; and (2) the reduced level of transparency that the 'additional level of recourse' would have, not only with regard to proceeds retained by the debtor, but also those received by the person who acquires the asset from the debtor.

The 'economic stability' of a security right depends on whether the right continues to exist after the transformation of the property.[155] Ideally, economic reality should inform the legal position in this regard.[156] The UNCITRAL framework recommends that the security right survives when the original encumbered property is commingled or transformed to form, respectively, part of either a mass or a product.[157] Under the OAS Model Law, the original security interest extends to attributable property – essentially including proceeds, a mass, and a product.[158] The EBRD Model Law includes the general provision that the charge extends to a right or thing 'attached or related to the charged property', which creates sufficient flexibility for the adopting country to decide how to incorporate provisions regarding a mass or a product. A mass or product is a new asset. Thus, the person who granted the original security right has either lost ownership in the original asset, or now holds joint ownership in a new asset (the mass or product). Accordingly, in the light of the security right being a right *in rem*, the existence or continuation of the security right is explained on the basis of either of the following theories: (1) a type of 'asset swap' (subrogation or substitution) takes place, whereby the 'old' security right now continues to exist over the new asset (the mass or product);[159] or (2) the security right in the mass or product is a 'new' and independent security right, but which inherits the priority ranking and commencement time of third-party effectiveness of the original security right. However, the 'new' right is limited to a specific value. The UNCITRAL Guide

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154 See the discussion of the competing interests of the secured creditor being able to follow proceeds and the lack of publicity for the transferee who receives the encumbered asset. See Chapter 3 paragraph 3.3.3.4 *supra*.

155 See E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 244 commenting that this links 'economic certainty with legal certainty'.

156 E Dirix & V Sagaert 'The new Belgian Act on security rights in movable property' (2014) 3 *EPLJ* 231 at 244.

157 Chapter 3 paragraph 3.3.3.1(*c*) *supra*. This approach is also followed under the Belgian Pledge Act of 11 July 2013 – see in respect of a mass art 20, and in respect of a product, art 18. Conversely, the Scottish Law Commission recommended that the security should be limited to the natural fruits of the encumbered property. See the Scottish Law Commission 2017 (2) report at 51, and s 44(3)(*b*) of the Draft Moveable Transactions (Scotland) Bill.

158 See Chapter 4 paragraph 4.3.3.2(*a*) *supra*.

159 The UNCITRAL states that the resulting product is in some sense a replacement or substitute. See Chapter II of the UNCITRAL Guide, para 95 at 90.

and UNCITRAL Model Law use different methods to determine the value of the extended security right, but the approach of the Model Law is more commercially viable. The UNCITRAL Model Law stipulates that the value of the security in the mass should be determined by using the proportion of the original encumbered asset to the mass (the new asset) and then assigning a value using that proportion. However, in the case of a product, the value of the original asset (the component) determines the value of the extended security right. This prevents the secured creditor from receiving a windfall if the transformation increases the value of the asset. The Model Law is, however, silent as to the position when the value decreases as a result of becoming part of a mass or a product.

As in the discussion *supra* with regard to extending the security right into a mass or a product, economic certainty should correspond to legal certainty when the encumbered movable property is fixed to immovable property. Both the OAS Model Law and the UNCITRAL Guide (but not the UNCITRAL Model Law) recommend that the security right in movable property which is subsequently fixed to immovable property, should remain effective after attachment.[160] However, the security right only remains effective where a secured creditor has complied with specific requirements, which differ in the different frameworks. Both the OAS Model Law and the UNCITRAL Guide require that the attachment retain its identity as a movable property despite being attached. The difference involves the method of publicity where: (1) in terms of the OAS Model Law, the security interest only continues after attachment if the attachment was *preceded* by registration in the *immovable* property registry; and (2) the UNCITRAL Guide suggests alternatives: either that the security right continue automatically after attachment (thus as part of the original registration in the movable registry); or that it continue via registration in the *immovable* property registry (as under the OAS Model Law).[161] It remains far from settled in domestic legal systems whether the security right in movable property fixed to immovable property and becoming part of the immovable property as a result of accession, should continue to exist.[162] The primary argument against extending the security

160 The EBRD Model Law applies to movable and immovable property so there is no need for a special recommendation regarding attachment to immovable property.

161 See *supra* Chapter 3 paragraph 3.3.3.1(*c*) and Chapter 4 paragraph 4.3.3.2.

162 Extending the security right to a fixture was rejected by the Scottish Law Commission. See the Scottish Law Commission 2017 (2) report at 48. Further, see the New Zealand PPSA which also rejects the extension. See M Gedye 'A distant export: the New Zealand experience with a North American style personal property security regime' (2006) 43 *Can Bus LJ* 208 at 214. Conversely, the Belgium Pledge Act of 11 July 2013 allows the security right to extend to the fixture (art 10), but the exact content of this right might require further clarification. See F Helsen 'Security in movables revisited: Belgium's rethinking of the Article 9 UCC system' (2015) 6 *Eur Rev Priv Law* 959 at 967.

right to attachments, turns on whether the secured transactions law framework should interfere with the law of immovable property.

(d) All-asset type security

A valid concern is that an all-asset type security can potentially lead to over-collateralisation. Consequently, the framework should allow for certain types of movable property to become excluded from the all-asset security. Both the UNCITRAL framework and the OAS Model Law recommend the establishment of an 'all-asset' security which can be taken in all the debtor's movable property, while allowing the debtor to dispose of specific encumbered property (inventory) in the ordinary course of its business.[163] The security right in all 'present and future assets of the debtor' – an all-asset security – automatically includes proceeds and future assets. The EBRD Model Law uses an enterprise charge as the functional equivalent of an 'all-asset' security. The former is a common-law approach and the latter a civil-law approach.[164]

An all-asset security is limited to movable property under of the UNCITRAL framework and the OAS Model Law, but the enterprise charge under the EBRD Model Law extends to both movable and immovable property.

(e) Secured obligation

The frameworks analysed in this thesis all recommend an extensive scope of application as regards the type of obligation that can be secured by a security right. It should be possible to secure most obligations, not only a monetary obligation.[165] Furthermore, the obligation can be a fluctuating and/or future obligation, provided that the obligation is determinable.[166] Also, a security right may secure more than one obligation. According to both the EBRD Model Law and the OAS Model Law, the secured obligation can be described either specifically or generally; while the UNCITRAL Model Law recommends a description that 'reasonably

163 Chapter 3 paragraph 3.3.3.1(*a*) and Chapter 4 4.3.3.2(*a*) *supra*. Article 10 of the Belgian Pledge Act of 11 July 2013 also includes a 'pledge of all sums' provision, which effectively includes all the debtor's assets.

164 J-H Röver *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (2007) at 72.

165 Securing a non-monetary obligation presents certain challenges, and presumably what is secured in this instance would be the damages resulting from the breach of a contractual obligation.

166 *Supra,* Chapter 3 paragraph 3.3.3.1(*e*) (UNCITRAL framework); Chapter 4 paragraph 4.3.3.2(*b*) (OAS Model Law); and paragraph 4.2.3.2(*d*) (EBRD Model Law).

allows their identification'. However, in terms of article 9(3) of the UNCITRAL Model Law, a generic description of 'all obligations owed to the secured creditor at any time' would meet the standard of what 'reasonably allows their identification'.[167]

5.4.2.2 Recommendation for reforming the South African framework

The reference to a 'comprehensive scope' applies to the type of assets that should be included under the registered pledge. It must be possible to register the pledge in respect of all types of corporeal movable property, apart from ships and aircraft. The starting point is to include all incorporeal movable property in the framework unless there is a policy reason to exclude them. There are a number of reasons why all types of incorporeal movable property should be included: (1) incorporeal movable property is becoming an increasingly valuable commodity to offer as security; (2) multiple categories of incorporeal movable property can be included under the meaning of 'proceeds'– eg, a contractual right to rental income, and the right to receive payments from an insurance policy; and (3) it would not be possible to comply with the general function of an 'all-asset' security, if certain incorporeal assets were excluded from the South African framework. However, as regards intellectual property and financial instruments, it should be possible to register a security right, but only to the extent that no other laws (domestic or international) provide otherwise.[168]

The strict specificity principle associated with special notarial bonds regulated by the SMPA, was introduced to create a 'deemed pledge'.[169] The recommended real security to be created through a registered pledge, as a non-possessory pledge, should be a non-possessory security right in its own right. There is, consequently, no reason to impose a strict specificity requirement to bring the non-possessory pledge as close as possible to the possessory pledge as the registered pledge will not share the characteristics of a possessory pledge. Doing away with strict specificity principles means the encumbered asset may be described both specifically and generically. Furthermore, the asset-description standard should reasonably enable identification of the encumbered movable property. A generic asset description

167 The understanding of the meaning of 'reasonably' was explained in 5.4.2.1(*b*) *supra*.

168 See S Karjiker 'Intellectual property as real security' (2018) 1 *IPLJ* 1-23, for a general summary on how the legal nature of intellectual property influences the possible use of this property category as real security. See also N Locke 'The use of intellectual property as security for corporate debt' (2004) 16 *SA Merc LJ* at 716-725.

169 Chapter 2 paragraph 2.5.2(*b*) *supra*.

'reasonably allows their [the assets] identification' if the type of asset is one where a specific asset description would not be reasonable in the peculiar circumstances.

It ought to be possible to register the registered pledge in respect of future assets. As mentioned above, the *nemo plus iuris* rule is not contravened when the real right exists only from the point at which the grantor has the right to encumber the asset. However, the *prior tempore* rule is arguably contravened where the priority of the real right is determined with reference to the registration date, which pre-dates the coming into existence of the future asset. The departure from the *prior tempore* rule is justified, however, as third parties are informed (through registration) of the possible existence of the real right in the future.

I recommend that the registered pledge extend to the proceeds of the originally-encumbered asset. The meaning of 'proceeds' must be broader than natural and civil fruits, and should include proceeds resulting from either the sale, lease, or licensing of the property, resulting from payment under an insurance policy in respect of the encumbered property.[170] In deciding whether or not to extend the proceeds of a registered pledge automatically,[171] the following facors should be considered: (1) that an all-asset security and future assets potentially include proceeds; and (2) that there should be publicity of the real right in the proceeds. Recommending that a different approach should apply to proceeds that do not form part of an all-asset security, would detract from the uniformity of the framework. Furthermore, transparency would be compromised where there is no notice that the security right extends to proceeds. The solution, in my view, is to allow a grace period, similar to that recommended in the UNCITRAL instruments, during which the real right in proceeds not mentioned in the registered notice (or which did not form part of an all-asset security), becomes enforceable against third parties for a limited period after the proceeds are created, after which the real right in the proceeds only *remains* effective if it is registered.

Moreover, my recommendation is to include a movable property category covering 'all the debtor's assets' within the comprehensive scope of the framework, but to also allow a security right to extend to an economic entity – eg, stock-in-trade. Including the option of using an economic entity as security would resolve the current problem of over-collateralisation in the general notarial bond – ie, that the bond can only be registered in respect of *all* the debtor's

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170 The EBRD Model Law specifically mentions payment in terms of an insurance policy, as proceeds to which a charge can extend to.

171 Automatically extending the right implies that the registered pledge in the original encumbered asset continues into the proceeds from that asset without having to register a separate registered pledge in the proceeds.

assets. I recommend that the commercially relevant all-asset security should reflect the following features: (1) it should be possible for the security to include current and future assets of the debtor; (2) it should be possible to use the security to secure current and future advances; and (3) it should be possible, where the debtor's inventory is sold in the debtor's ordinary course of business, to transfer the inventory to a subsequent buyer free from any encumbrance. However, to balance the unfair position where the secured creditor effectively loses inventory as the encumbered asset, the security right must be capable of extending to the *proceeds* of the sale of such inventory. This is also why I recommended *supra,* that the registered pledge must extend to proceeds.

A further recommendation is to allow what I loosely refer to as an 'asset swap', where the secured creditor would have a security right in the mass or transformed product jointly with other secured creditors, but only to the maximum of the value of the quantity of her component of the commingled asset, or the value of her component that formed part of the transformed product. The issue with extending the security right to a mass or a product is the lack of transparency of this extended real right for the person who acquires the mass or product. Nevertheless, this is balanced, to some extent, by limiting the value of that right to the value of the pre-commingled or pre-transformed asset. Despite any formal objections to extending the real right to a mass or product, such a recommendation makes commercial sense. I argue that secured creditors are attempting by contract, to mitigate the risk of the real right being lost when the collateral becomes part of a mass or product.[172] By not allowing the real right to extend to a mass or product, the legal function of the real security law framework will not be realised.[173]

It is unfair for a South African secured creditor to lose her security right when movable property is attached to immovable property (which is the somewhat archaic position in many domestic systems). Also, this rule possibly discourages financiers from financing transactions involving such movables. The potential issues associated with establishing a rule that the security right survives after the asset has been affixed to immovable property, include that: (1) the attached movable property could be classified as immovable property after attachment;[174] and (2) because the publicity of the security right in the fixture takes place in a *movable*

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172 I submit that most credit agreements prohibit the debtor from using the collateral to form part of a mass or manufactured product.

173 See paragraph 5.2.1 *supra* which explains the legal function as an element of legal efficiency.

174 The real right in the original asset only extend to *movable property.*

property registry, there would be a lack of publicity for subsequent transferees of the immovable property to which the fixture has been attached.

In addressing the first issue, it must be established whether the real right would be limited solely to the value of the attached movable property (as is the position with a product or a mass), or whether the right would actually allow the secured creditor to remove the attached movable property.[175] This distinction influences whether or not the rules applicable to accession can be disregarded. The second issue would be resolved if the recommendation of the OAS Model Law and one of the options in terms of the UNCITRAL framework – registration of the security right in an immovable property registry – is adopted, which is also the recommendation I make.[176]

Furthermore, it is proposed that the description of the secured obligation should reasonably allow for the identification of that obligation, similar to the application of this standard to encumbered assets as recommended *supra*. The secured obligation must at least be determinable, while both future and fluctuating obligations should also be capable of being secured.

5.4.3 A simple process for creating the security right while maintaining a security right that fulfils the essential qualities of a property right

5.4.3.1 Analysis of the fundamental principle

This fundamental principle considers whether the South African framework should introduce a *contractually*-created security right that is also a property right. The legal function of a secured transactions law framework is fulfilled when the secured creditor has recourse to the debtor's assets when the debtor defaults. Thus, the security right must be a right *in rem*, not merely a personal right against the debtor,[177] and this is indeed the approach recommended by all the legal frameworks analysed. In analysing the implementation of this fundamental principle one must consider whether a contractually-created security right (which is also a property right) should either be: (1) enforceable only between the parties (the recommendation

175 I prefer that that the real right only extend to the value of the movable property.
176 Section 31 of the Land and Agricultural Development Bank Act 15 of 2002 already allows for an agricultural charge over movables to be registered against the title deed of the immovable property.
177 In the South African context this would be a limited real right.

of both the UNCITRAL framework and the OAS Model Law)[178] until a separate and subsequent act of publicity results in the third-party effectiveness of the security right (*erga omnes* enforceability);[179] or (2) whether the security right should be created and immediately be enforceable against the world (the approach followed in the EBRD Model Law).[180] The difference in approach centres on whether there is a practically relevant yet legally sound justification for a clear separation between the creation and third-party effectiveness of a security right. The primary justifications for this clear separation are set out *infra,* followed by why the justification should be accepted or rejected.

The first justification for separating third-party effectiveness from creation is that the security right should be created through a quick and simple process that allows the secured creditor recourse to the debtor's asset as security for the secured debt. However, for the security right to have any practical effect, it must withstand challenges from third parties (or at least other unsecured creditors). Accordingly, it is my view that a contractually-created security right is only meaningful where no third parties can stake a claim to the encumbered asset. Furthermore, the justification that a clear separation between creation and third-party effectiveness allows multiple security rights to co-exist in the same asset, is unconvincing as: (1) this security right cannot be enforced against the other secured creditors who have a security right in the same asset (the right applies *inter partes*); and (2) it is already possible for multiple secured creditors to hold a security right in a single asset even where there is no clear separation between creation and third-party effectiveness of the right.[181]

Another possible justification is that separation would allow the inclusion of rights under title-based security devices in a unitary or uniform secured transactions law framework – rights which rights are created *via* contract alone (no publicity). This justification carries weight if the reform project intends to follow either a unitary or a uniform approach, which is not my recommendation for South African reform. Therefore, these arguments for justifying the maintenance of a clear separation between the creation and third-party effectiveness of the

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178 Chapter 3 paragraph 3.3.3.5 (UNCITRAL framework) and Chapter 4 paragraph 4.3.3.3 (OAS Model Law) *supra*. Thus, the property right under these frameworks is not a traditional property right, but resembles a personal right, bar having recourse to the debtor's property not only to the debtor's person. Nevertheless, the right is not yet enforceable against any third party.

179 Third-party effect resulting from: (1) registration; (2) transfer of possession or control; or (3) automatic third-party effect when the security right is extended to the mass, product, proceeds or attachment. See *supra* Chapter 3 paragraphs 3.3.3.4(*b*) and 3.3.4.6 (concerning acquisition financing under the UNCITRAL framework) and Chapter 4 paragraph 4.3.3.3 (concerning the OAS Model Law).

180 Chapter 4 paragraph 4.2.3.2(*b*) *supra*. Thus, the charge is a property right in the traditional sense, where the right is created and becomes effective against third parties at the same time.

181 These justifications were discussed *supra* in Chapter 3 paragraph 3.3.3.5(*a*) (UNCITRAL framework).

security right, are rejected for future South African reform. Ultimately, a secured transactions law framework must co-exist within the principles of an existing property law framework. Therefore, in my assessment, South African law is not at this point ready to recognise a contractually-created property right which applies *inter partes* only. Moreover, a legally efficient secured transactions law framework can be developed without a clear separation between the creation and third-party effectiveness of a security right. This is explained in greater detail *infra*.

5.4.3.2 Recommendation for reforming the South African framework

Under the current South African framework, a limited real right is created and becomes effective against third parties simultaneously. The question is whether this approach renders the framework ineffective. My assessment is that it does not. To have recourse to the debtor's asset holds little value if the security is not also enforceable against third parties. Also, title-based security devices should continue to fulfil a real security *function* only. The recommendation *supra* was that, for the present, title-based security devices should not be reclassified as a security right, but that the problems associated with using these devices should first be corrected.[182]

I recommended *supra* that the South African framework must follow a commercially facilitative in preference to a unitary approach or a uniform application of rules. Thus, there is no reason to have a clear separation between creation and third-party effectiveness to accommodate title-based security devices under the same framework as other security rights. Accordingly, the recommendation is that if the publicity method is simple (which is currently not the case) and if the priority in respect of a future asset can be established with reference to an earlier registration date, it is not essential to have a clear separation between the creation and third-party effectiveness of the security right. Instead, these two events should continue to take place simultaneously.

5.4.4 Registration in a general registry as the primary method of publicity, while also recognising specific secondary publicity methods

[182] The main concerns relate to the lack of transparency and the unfair consequences that the debtor suffer at time of enforcement.

5.4.4.1 Analysis of the fundamental principle

This recommended fundamental principle concerns transparency as a fundamental principle of property law.[183] The primary method for establishing publicity must be registration, but a framework should also accommodate other publicity methods – albeit as secondary. Whether it is possible to use a secondary method, depends on whether the securing asset or the type of security device requires that the security right be perfected using another form of publicity – eg, (1) receiving control of the encumbered assets in the case of a security right in the funds credited to a bank account, or in the right to proceeds in terms of an independent undertaking;[184] or (2) receiving possession in the case of a right under a negotiable instrument.[185] In effect, an unregistered security right should be the exception rather than the rule. The EBRD Model Law is the only framework analysed where an unregistered, title-based security right – the unpaid vendor's charge – is permitted.

Under the frameworks considered, a modern registry system will have certain features. The first feature is a simple, user friendly enough registration system which provides sufficient information on the nature of the security right.[186] Another feature recommended by all these frameworks, is registration in a general, electronic, and fully automated registry which is accessible virtually anywhere.[187] Moreover, the registry staff should not review the legality of the notices; they should, as far as possible, be subject to electronic preliminary screening of the notices.[188] Also, the consensus is that a debtor-based filing system is preferred over an asset-based filing system.[189] It is also essential to design the filing system with due consideration of

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183 The transparency principle is made up of the specificity principle and the publicity principle.

184 The right to the payment of funds credited to a bank account obtains third-party effectiveness either through control or by registration of a notice. However, third-party effectiveness by control enjoys a higher priority above third-party effectiveness established by registration (recommendation 101 of the UNCITRAL Guide). Obtaining control involves signing a tripartite control agreement, between the grantor, the creditor and the financial institution where the bank account is held.

185 Chapter 3 paragraph 3.3.3.6 (UNCITRAL framework), Chapter 4 paragraph 4.2.3.2(*e*) (EBRD Model Law), and Chapter 4 paragraph 4.3.3.4 (OAS Model Law) *supra*.

186 This means enough information to allow the creditor to perform proper due diligence to be certain enough of the risk associated with advancing credit to the debtor.

187 The system should be electronic, and allow remote access and filing while the registry staff need not check the accuracy of the filing (this is also the recommendation in s 119 of the Moveable Transactions (Scotland) Bill). See also *supra* Chapter 3 paragraph 3.3.3.6 (UNCITRAL framework), Chapter 4 paragraph 4.2.3.2 (*e*) (EBRD Model Law), and paragraph 4.3.3.4(*b*) (OAS Model Law).

188 I submit that using an algorithm specifically developed for this purpose, should be investigated for all future registries. The screening may be to check that the identity numbers are correct or that the alphanumeric number included has a sufficient number of digits.

189 It is problematic to operate an asset-based registry without having unique identification numbers for each asset. Even though the Cape Town Convention and its Protocols recommend asset-based filing (see Chapter 3 paragraph 3.2.1 *supra*), this is the exception and suits the unique character of the Cape Town Convention framework.

what the substantive law requires. For example, the design of the registry must consider: (1) whether the asset description in the notice and in the security agreement must coincide, taking account of the extent to which the specificity principle applies;[190] (2) whether the country subscribes to a positive or a negative system for the transfer of rights;[191] and (3) how comprehensive the scope of the legal framework should be. Another important feature is for the registry design to strike a balance between being 'fast and inexpensive' while ensuring 'security and searchability' of the information.[192]

The reforming country can introduce the above features, albeit using different options (or choices) when designing its registry system. Thus, a recommendation for the establishment of a general registry should also take account of: (1) whether notice filing, transaction filing, or a different form of registration should be used; (2) whether the current infrastructure can accommodate the registry in the format recommended by substantive law;[193] and (3) whether specific security devices should be registered in different registries – eg, one register for statutory pledges and another for the registration of assignations (transfers of rights),[194] or whether a single register is preferable.[195] The choice as to the nature of a registration system is often between notice-filing (recommended under the UNCITRAL framework and the OAS Model Law) and transaction-filing (recommended under the EBRD Model Law).[196]

Notice-filing generally coincides with a clear separation between the creation and third-party effectiveness of the security right (as under the UNCITRAL framework). However, it is also possible to use transaction-filing in systems where creation and third-party effectiveness are separated (as in the Belgian Pledge Act of 11 July 2013).[197] Notice-filing involves filing a

190 For example, most frameworks recommend that the description in the filed notice must allow reasonable identification, but the UNCITRAL Model Law goes further by adding additional asset description requirements. See Chapter 3 paragraph 3.3.3.6 *supra*.

191 See Chapter 2 paragraph 2.3.3.3(*g*) *supra* confirming that South Africa follows an abstract registration system.

192 See the recommendation in the UNCITRAL Registry Guide, Chapter 3 paragraph 3.3.3.6 *supra*.

193 This entails whether there is an existing registry that can be used or whether a new registry must be developed from scratch. Also, this involves considering whether the registry should be operated by government or a private entity.

194 This is a recommendation by the Scottish Law Commission. See the Scottish Law Commission 2017 (1) report at 10 and its Chapter 6 dealing with the 'Register of Assignations'.

195 A legal framework that follows either a unitary or uniform approach would only need one registry.

196 The suggested Scottish law reform opts for transaction-filing whereby the registration of the statutory pledge should be accompanied by the constitutive document, See s 91(2)(*a*)(ii) of the Draft Moveable Transactions (Scotland) Bill.

197 E Dirix 'The new Belgian Act on security interests in movable property' (2014) 23 *Int Insolv Rev* 171 at 177.

simplified document – a financing statement – containing limited information.[198] Indeed, notice filing serves to provide notice that a security right *possibly* exists, not that there is conclusive proof that a security right exists.[199] The potential creditor would have to make further inquiries to confirm whether the security right exists. Accordingly, a notice-filing system is only useful where it is accompanied by proper due diligence measures,[200] which would also require that the lender who is listed in the notice is willing to disclose the details of the secured transaction.[201] While filing the finance statement (the process of notice-filing) is quick and inexpensive, I contend that adding the effort required to conduct due diligence increases the time and cost resulting from using a notice-filing system.

Notice-filing can take place even before the secured transaction has been concluded (referred to as advance-filing). Moreover, a single notice can relate to multiple secured transactions. Indeed, notice-filing provides greater flexibility for the parties, but as the notice is not connected to an *individual* transaction,[202] the information in the registry is less relevant and reliable than information made available when using transaction-filing.

Transaction-filing involves registering the security right itself – it confirms that a security right exists.[203] A consequence of the basic concepts behind transaction-filing is that a specific registration can only relate to a single security right,[204] albeit in multiple encumbered assets. Another reform choice is to decide between different types of transaction-filing. Transaction-filing involves either filing the complete security agreement, or filing information about the secured transaction without having to file the complete security agreement.[205] The latter option arguably ensures that enough information is available, while still maintaining an adequate level of confidentiality.[206] Another possibility is to require the submission of a copy of the security

198 Accordingly, the security agreement is not registered. However, an option to consider is that the secured creditor should still file a copy of the security agreement, but that this agreement is not made part of the public notice.

199 See Scottish Law Commission 2017 (1) report para 6.14 at 68. See also HC Sigman 'Perfection and priority of security rights' (2008) 5 *ECFR* 143 at 151. Further see DJY Hamwijk *Publicity in Secured Transactions Law: Towards a European Public Notice Filing System for Non-Possessory Security Rights* (2014) (published LLD-thesis: Universiteit van Amsterdam) at 265.

200 Due diligence measures are those measure a potential creditor would use to obtain more information and then assess the risk of advancing funds to a debtor.

201 DJY Hamwijk *Publicity in Secured Transactions Law: Towards a European Public Notice Filing System for Non-Possessory Security Rights* (2014) (published LLD-thesis: Universiteit van Amsterdam) at 270.

202 HC Sigman 'Perfection and priority of security rights' (2008) 5 *ECFR* 143 at 151.

203 Scottish Law Commission 2017 (1) report para 6.18 at 69.

204 This is because the registered information concerns a *specific* transaction.

205 The Belgian Pledge Act of 11 July 2013 adopted the latter approach.

206 Also, technology could assist where the registry allows the security agreement to be uploaded, but then blocks the system from providing general public access to this security agreement. Accordingly, confidentiality of the security agreement can be maintained.

agreement before filing can take place. In this case the copy of the agreement is not made public.[207]

The choice of the type of registry and how it is designed depends on whether the adopting country's existing infrastructure is able to accommodate a specific type registry. If a country does not have an existing registry focusing exclusively on the registration of security rights in *movable* property, there are two possible solutions. The first is to develop a registry from scratch; the second is to use an existing movable or immovable property registry.[208] This is South Africa's current approach in using the land registry to register notarial bonds under the SMPA.[209]

5.4.4.2 Recommendation for reforming the South African framework

The inefficiency of the current registry system is partially responsible for sparking my research interest in reforming the current South African framework.[210] Ultimately, the recommendations made in paragraph 5.4 of this chapter will fail if it is not possible to introduce a movable property registry that can facilitate their implementation. Essentially, a functional registry is the foundation on which the implementation of the recommended framework will stand or fall.

The issues associated with the current practice of registering notarial bonds in the immovable property registry include: (1) that the system is costly; (2) that the system is cumbersome, in the main because it is paper-based and requires the involvement of attorneys in the process;[211] and (3) that the registry information is not freely accessible and so does not fulfil the true purpose of publicity: to inform third parties of the right embodied in a notarial bond. During the final stages of writing this thesis, the Electronic Deeds Registration Systems Act was signed into law.[212] The Act provides for the development of an electronic deeds

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207 This would also prevent frivolous filings from taking place.

208 See also HC Sigman 'Perfection and priority of security rights' (2008) 5 *ECFR* 143 at 156 commenting that many European movable registries replicate the land registries.

209 The second option is not ideal, since this type of registry (the land registry) was specifically developed with immovable property in mind. Also, in many underdeveloped legal systems, immovable property registries tend to be exclusively paper-based, cumbersome, and expensive to operate.

210 See the memorandum on the objects of the Electronic Deeds Registration System Bill at 5, included as part of the Electronic Deeds Registration Systems Bill B35B 2017.

211 See Chapter 2 paragraph 2.5.6 *supra* which discuss cost and other issues associated with the registration of South African notarial bonds. Nevertheless, the Electronic Deeds Registration System Act 19 of 2019 was signed into law. The purpose of the new system is to allow the electronic processing, preparation, and lodgement of documents with the Registrar of Deeds according to J Richardson 'Electronic deeds registration system act becomes law' *The South African*, available at https://www.thesouthafrican.com/news/electronic-deeds-registration-system-act-becomes-law/ (date of access: 3 October 2019).

212 19 of 2019 in *GG* 42744 of 3 October 2019.

registration system. Arguably, having an electronic deeds registration system would improve some of the problems associated with the registration of notarial bonds. Nevertheless, the new electronic deeds system will probably not correct most of the flaws identified in this thesis when it comes to the use of notarial bonds (such as the involvement of attorneys and restricted access to information). The adoption of this new statute, therefore, does not change the key recommendation of this thesis: that the current registration system for special notarial bonds should be replaced with registration in a general registry (or registries) exclusively reserved for the registration of security rights in *movable* property.

It is further recommended that registration in the newly established general registry should take the form of transaction-filing, considering the recommendation made *supra* that the creation and third-party effectiveness of a security right should happen simultaneously. As regards the issue of confidentiality, it should not be a requirement to register the security agreement (referred to as the 'real agreement' in the South African context) for *public* access.[213] Therefore, it would be sufficient to register details of the secured transaction. However, it should be set as a requirement that the real agreement must have been concluded at the time of the registration. This would be evidenced by the submission of a notarised copy of the real agreement before registration can take place. The copy of this document should not, however, be made public.

The recommendation is to avoid a public entity operating the registry and/or registries. Instead, the recommendation is to allow a private entity to develop the online registration platform from scratch. Developing a new system, but using existing technology, is appropriate as the new registry would be developed to comply with the requirements of the prescribed legal framework and with regard to the mobility of movable property at its foundation.[214] A viable option is to mandate South African credit bureaus to establish and operate the electronic registration platform.[215] As credit bureaus are well regulated in South Africa and already provide other services to financial institutions, they would be able to use existing technology

213 The extent in which the registry would lawfully process the personal information of the parties would have to comply with the conditions imposed by the Protection of Personal Information Act 4 of 2013.

214 The registration of special notarial bonds functions in a registry framework normally used for the registration of rights in immovable property. Accordingly, the provisions concerning special notarial bonds provide structure to functioning within an immovable property registry.

215 Informal communication with the Agricultural Committee of the Banking Association of South Africa (BASA), reflects that there is an ongoing study into establishing a registry for cessions, but limited, for the present, to cessions involving agricultural finance.

and expand on it when developing a new registry.[216] Every effort should be made to establish an entirely electronic registration system (or systems), and paper-based filing should only be allowed during a transitional period. [217]

As recommended *supra*, two separate electronic registries should be established. The recommended structure of the security devices discussed *supra*,[218] requires that two separate registers be created: (1) a pledge register; and (2) a register for title-based security devices. The pledge register should record the creation of a non-possessory security right in any movable property (unless specifically excluded from the framework), as well as a security right in certain categories of incorporeal movable property (which would include the registration of claims as discussed *supra*).[219] This register must also allow for the registration of a security right in a possessory pledge and so will not influence the creation of the pledge or the cession,[220] but potentially could determine the priority ranking of this pledge right if this is the chosen route. The preliminary recommendation is to allow for the registration of cession *in securitatem debiti* (in respect of the pledge of incorporeal movable property only), but this question should be investigated further as part of future research and/or a larger reform project of the law of cession in general.

The second register should record the voluntary registration of rights in terms of particular categories of title-based security devices: (1) retention-of-title; (2) instalment agreements; and (3) the out-and-out cession of claims. Registration in this registry should in no way be used to confirm ownership of movable property as such an approach would be a 'step too far' given the current state of development of South African property law. However, the possibility of using the entries in this registry to confirm the ownership of specific categories of movable property (specifically motor vehicles) should be considered in future research and, for example, when this electronic platform is being developed.[221] Despite not

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216 Credit bureaus are governed by the NCA and its Regulations and the National Credit Regulator regulates credit bureaus. Furthermore, as soon as the regulator responsible for regulation in terms of the Protection of Personal Information Act 4 of 2013 is fully operational, credit bureaus will also be regulated by this regulator with regard to how they deal with personal information. See https://www.cba.co.za/legislation/ (date of access: 24 September 2019).

217 The notarised copy of the real agreement is uploaded electronically as pre-registration step; thus it is not a hindrance to adopting an electronic system.

218 See paragraph 5.4.1.3 *supra*.

219 See paragraph 5.4.1.2 *supra* where the recommendation is to allow for the registration of claims while also allowing a cession and pledge to be registered. The difference between the registrations is whether the registration creates the real right (registration of claims) or whether registration merely influences priority (registration of the cession *in securitatem debiti*).

220 The references to 'cession' are limited where the pledge construction is used.

221 No electronic system exists for South Africans by which to verify the ownership details of motor vehicles or high-value equipment.

being a requirement as such, registration in this second registry would, of course, ensure that this type of right is no longer a 'secret right' and could provide a platform for exploring the recognition of a security transfer of ownership outside of the cession context. Another reason for developing the second registry, is to facilitate access to public information on the taxable wealth of individuals which could assist institutions like the South African Revenue Services.

5.4.5 Priority rules that are transparent and predictable

5.4.5.1 Analysis of the fundamental principle

The ground rule underpinning this fundamental principle of priority is the general rule of *prior tempore potior jure* – first in time is stronger in right.[222] The fundamental principle of having transparent and predictable priority rules plays a pivotal role in maintaining certainty as a feature of legal efficiency. Priority rules are transparent and predictable where: (1) the general rule of determining priority on a temporal basis is applied consistently (recommended by all the frameworks analysed);[223] and (2) there is an established, closed-list of exceptions to the general priority rule based on sound policy considerations. These exceptions to the general priority rule could include: (1) higher priority for acquisition financing (subject to specific requirements under the UNCITRAL framework and the OAS Model Law); (2) that the parties are able to subrogate their priority ranking contractually; and (3) that the priority ranking of a security right in a future asset is determined not with reference to when the right comes into existence, but when the registration of the right occurs. Finally, the framework could also accommodate exclusive statutory security rights reserved in favour of the state which would rank higher than other security rights.[224] However, because such extraordinary rights in favour of the state are far-reaching, they should preferably be kept to a minimum.

Another aspect which can be regarded as an amendment of the general rule, relates to how priority persists after a new asset (a mass or a product) comes into existence. The UNCITRAL framework suggests that the priority of a security right that existed in an element or component of what is now a mass or a product, continues to operate over the transformed asset in a unique manner.[225] A group of creditors may all have a security right, each with a

222 See the discussion of this ground rule in Chapter 2 paragraph 2.3.3.3(*c*) *supra*.
223 See *supra* Chapter 3 paragraph 3.3.3.8(*a*) (UNCITRAL framework), Chapter 4 paragraph 4.2.3.2(*k*) (EBRD Model Law), and paragraph 4.3.3.5 (OAS Model Law).
224 For example, the statutory preferential rights reserved in favour of the South African Land and Agricultural Development Bank, mentioned in 5.4.5.2 *infra*.
225 Chapter 3 paragraph 3.3.3.8(*c*) *supra*.

specific priority ranking, in encumbered property which either becomes an element of a newly formed mass, or a component of a new product. Where the encumbered property becomes an element of a mass, the priority ranking of the creditors holding a security right in that element remains intact as between those creditors. However, the priority only exists in a *quantity* of the mass that is equal to the original encumbered element, not in the mass as a whole. Moreover, where the encumbered property becomes a component in a new product, the priority ranking of the creditors with a security right in that component also remains intact as between those creditors. However, in this case the priority persists only with regard to the *value* of the component immediately before it became part of the product.[226]

5.4.5.2 Recommendation for reforming the South African framework

The recommendation is that the general rule – first in time is stronger in right – should continue to apply under the South African framework. However, I suggest three exceptions to this general rule: (1) that to investigate the possibility that the priority ranking of the possessory pledge (within the wider meaning intended *supra*)[227] is established with reference to the date of registration (even though the right itself is created on transfer of possession); (2) that parties should be allowed to agree to subrogate their priority ranking contractually; and (3) that the priority ranking of a security right in a future asset be determined with reference to the date on which the security right is registered, not when the asset materialises.[228] Also, a consideration for possible further study is whether the statutory preferential real right conferred on the South African Land and Agricultural Development Bank (Land Bank) should continue under in a new framework as an exception to the general priority rule.[229] The application of these exceptions, recommended or existing, is discussed *infra*.

The general rule is that the priority of a possessory security right is determined with reference to when possession is transferred. However, this transfer is not necessarily widely broadcast, and therefore in practical terms, it could today be regarded as a 'secret right'. Thus, a possible solution is to register a possessory security right to establish priority. A possessory security right should be created by transfer of possession or control, but the priority for all real

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226 Chapter 3 paragraph 3.3.3.8(*c*) *supra*.

227 This includes traditional possessory pledges and cession, but only relating to the pledge construct.

228 Effectively the security right will exist from a future date, but an earlier date (the date of registration) will be used to determine its priority ranking.

229 See the discussion of the impact of this preference on a prior registered special notarial bond under the SMPA in Chapter 2 paragraph 2.5.7 *supra*.

security rights should be based on the date of registration.[230] The lack of registration of the possessory pledge does not result in the pledge becoming unsecured in case of insolvency. Furthermore, it should not be possible for a registered pledge to vest over assets already encumbered by a possessory pledge (regardless of whether the pledge is registered).[231] Thus, the registration of the possessory pledge serves to notify a potential creditor that she is not able also to take a registered pledge over the assets already subject to a possessory pledge.

Because this thesis does not recommend the recharacterisation of title-based security devices, there is no reason to introduce a special exception for the priority right of an acquisition financier. Furthermore, because it is recommended that the framework should be comprehensive enough to include future assets, the proposal is that the priority ranking of a security right should be determined with reference to its date of registration rather than the date on which the future asset materialises. A registered pledge can only be a dynamic security device where the same principles for determining priority apply to security rights over both existing and future assets.[232] This implies that the date of registration should be used to determine the priority ranking irrespective of when the security right comes into existence.

5.4.6 The seller (creditor) should not be permitted to benefit unfairly from using a title-based security device

5.4.6.1 Analysis of the fundamental principle

Most of the legal frameworks discussed in this thesis (save for the EBRD Model Law) include the fundamental principle that creditors should be treated equally.[233] However, because this thesis recommends implementing a commercially facilitative approach, title-based security devices would not necessarily have to follow the same legal rules as other security rights (which would be the position under a unitary or uniform approach).[234] However, a legal framework

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230 As the exception applies to real security rights, rights originating from title-based security devices are excluded.

231 Similar to a special notarial bond in terms of the SMPA which is 'subject to any encumbrance' that already rests on the bonded property. See Chapter 2 paragraph 2.5.7 *supra*.

232 See the characteristics of a dynamic security device that should apply to the recommended registered pledge listed at 5.4.1.2(*d*) *supra*.

233 The UNCITRAL instruments places specific emphasis on this equal treatment. See *supra* Chapter 3 paragraph 3.3.3.11 and then paragraph 3.3.4 for the detailed discussion of the recommended approach to acquisition financing.

234 See the reference to the functional and formalist approaches and how they apply to acquisition financing devices in NO Akseli *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) at 227.

that applies to title-based security devices could potentially lead to unfairness for the buyer when it comes to enforcement.[235] Third-parties are arguably also not adequately protected from the consequences of the lack of transparency with regard to the rights under title-based security devices. Thus, the recommendations *infra* for reform of the South African framework include: (1) how the publicity of these rights should be improved; and (2) whether the enforcement measures associated with title-based security devices should be amended.

5.5.6.2 Recommendation for reforming the South African framework

The issues associated with title-based security devices were explained in Chapter 2, *supra*.[236] There are basically three aspects to consider in reforming the legal framework applicable to title-based security devices: (1) whether the current title-based security devices should be changed into something similar to the unpaid vendor's charge; (2) whether voluntary registration of the rights under title-based security devices should be possible; and (3) the extent to which the enforcement measures should be amended to achieve a fair outcome for the buyer (debtor).

To introduce a security device similar to an unpaid vendor's charge would mean that the seller effectively trades 'ownership' for a lesser right – albeit a security right with a higher priority than other 'normal' security rights. Furthermore, instalment agreements are: (1) recognised and frequently used title-based security devices in South Africa; (2) and are entrenched in consumer credit legislation (the NCA). This study recommends that the basic structure of the current title-based security devices should remain as is for a number of reasons. First, there will be resistance to change the legal framework governing instalment agreements (especially as it also forms part of the NCA) and the framework would still be fragmented were only security transfer of ownership and retention-of-title (thus excluding instalment agreements) to be taken up in the unpaid vendor's charge. Although the legal frameworks analysed recommend that consumer law be excluded from the secured transaction law framework, instalment agreements (both within and outside the scope of the NCA) form an integral part of the current South African secured transactions law framework. In other words, now is probably not the time to reform title-based security devices as such a change needs to coincide with reform of the NCA and the asset-based lending structure of South African

235 See the discussion of some of those issues in the South African context in Chapter 2 paragraph 2.6.3 *supra*.
236 Chapter 2 at paragraph 2.6.3 *supra*.

financial institutions. Nevertheless, the lack of transparency associated with title-based security devices must be addressed incrementally, and my recommendation is to allow for voluntary registration (at least for the present). Depending on how such voluntary registration operates in practice, it should then be considered whether to take the next logical step and make registration compulsory. Since title-based security devices involve the reservation of *ownership* – ownership is more than a limited real right – rights under title-based security devices should be recorded in a register separate from the register established for registered pledges. The registration of title-based security devices would not confirm the title in the encumbered asset. Instead, the exclusive purpose would be to notify the world that certain parties have concluded a transaction whereby they used 'title' in a particular asset to secure the fulfilment of the debtor's obligations. Credit agreement information, for both individuals and corporations, is already captured by South African credit bureaus. Consequently, financial institutions would in all likelihood be amenable to the the minimal additional effort required to register the existence of such rights on an electronic platform as recommended *supra*.[237]

As the law currently stands, the South African debtor is faced with two instances where the enforcement measures could potentially result in an unfair advantage to the seller (creditor). The first issue is that if the debtor defaults, the seller may take possession of the collateral and either sell it or retain the asset without having to account to the debtor (unless the transaction is subject to the NCA).[238] Depending on the value of the property and the extent of the debt, this could be seen to contravene an essential principle of South African real security law – a creditor should not be unjustly enriched at the expense of a debtor.[239] The seller may be unjustly enriched, and although the buyer can pursue a claim based on unjustified enrichment against the seller, I recommend the inclusion of a prohibition on the unjustified enrichment of the seller, akin to article 72 of the Belgian Pledge Act of 11 July 2013. Article 72 of the Belgian Pledge Act resolves this problem by providing that the seller must account for any excess (after the property has been sold) to the buyer. I further recommend that this should be included as a statutory obligation forming part of a comprehensive statute on movable property transactions.

The second issue surrounding enforcement involves section 84 of the Insolvency Act which currently creates a statutory hypothec in favour of the *seller* only when the debtor under an *instalment agreement* becomes insolvent. The statutory hypothec does not extend to other

237 See paragraph 5.4.4.3 *supra*.
238 See mention of the position under s 127 of the NCA in Chapter 2 paragraph 2.6.2 *supra*.
239 According to Brits, this is a foundational principle of South African real security law. See R Brits *Real Security Law* (2016) at 165.

types of title-based security device – eg, a retention-of-title. Providing the seller with a real security right in the proceeds resulting from the sale of the encumbered asset while allowing the asset to fall into the insolvent estate, benefits the *concursus creditorum*.[240] The latter is arguably also why the Insolvency Act does not currently address the unfair position of the buyer who must be content with a concurrent claim for the portion of the purchase price already paid under an instalment agreement. This position is not likely to change as the collective interest of the creditors of an insolvent estate would be more important than the interest of an individual buyer (debtor). Nevertheless, if the legislator decides to improve the unfavourable position of the debtor, two options are available. First, where the buyer (debtor) has paid a substantial portion of the purchase price,[241] the trustee of the seller's insolvent estate *must* give the buyer the option to pay the remainder of the purchase for ownership of the movable property to pass to her. Second, the buyer could also be classified as a secured creditor, but only where she has paid a substantial portion of the purchase price.[242] Again, this statutory obligation should form part of a comprehensive statute.

5.4.7 The creditor's enforcement rights must be as broad as reasonably possible

5.4.7.1 Analysis of the fundamental principle

The legal function of a secured transactions law framework is achieved when the secured creditor can successfully enforce her security right against the collateral, and the interests of the debtor are protected during enforcement. The general trend is not to prescribe what should amount to a 'default' and, therefore, the parties can stipulate its meaning in the security agreement.[243] Most of the legal frameworks analysed recommend implementing a general standard against which to measure the enforcement measures. Although this standard is phrased differently in the different frameworks, they basically amount to the same standard. For example, enforcement must take place 'in good faith and in an economically responsible manner' (the wording in the Belgian Pledge Act), or in a 'commercially reasonable manner'

240 Meaning the 'coming together of the debtor's creditors' when the debtor becomes insolvent.

241 The meaning of 'substantial' would develop through court interpretation.

242 A similar provision exists where immovable property is bought on instalments. Section 22 of the Alienation of Land Act 68 of 1981 allows the purchaser, in event of the insolvency of the registered owner of land, to claim transfer of the immovable property into the name of the purchaser subject to the payment of the outstanding balance of the purchase price.

243 None of the analysed frameworks has a recommendation on the exact meaning of 'default'. This is also the approach implemented under the Belgian Pledge Act of 11 July 2013. See in this regard F Helsen 'Security in movables revisited: Belgium's rethinking of the Article 9 UCC system' (2015) 6 *Eur Rev Priv Law* 959 at 988.

(the wording in the UNCITRAL framework),[244] or in line with 'reasonable standards of commercial practice' (the recommendation of the Scottish Law Commission).[245] If this general standard is not implemented, the recommendation of the legal frameworks analysed is that the debtor should be permitted to approach a court either to obtain an interdict to stop the enforcement proceedings, or, if the disposition has already taken place, to claim damages from the secured creditor.[246] Imposing a general standard for enforcement measures also qualifies as a safeguard to protect the debtor's interest during the enforcement process.

In general, the modern approach to enforcement of a security right is to allow swift enforcement with as little involvement by the courts as possible. This fundamental principle covers different stages of the enforcement process and relates to: (1) being able to take possession of the collateral; (2) being able to sell (or lease or license) the collateral; and/or (3) the possibility of acquiring the encumbered asset from the debtor[247] at a fair price in full and final settlement of the outstanding debt. The enforcement measures recommended in the legal frameworks considered, differ with regard to the level of court involvement and the nature of the suggested safeguards (or additional measures) aimed at protecting the interests of the debtor and other interested parties. All the legal frameworks endorse extrajudicial enforcement (enforcement without court involvement) in some or all stages of enforcement. For example, although the OAS Model Law advocates expedited judicial proceedings to grant the secured creditor possession under an attachment order, it is possible that extrajudicial disposition can take place without a court order. However, where extrajudicial enforcement is permitted, all the frameworks suggest that the debtor should have the right to approach a court where she has suffered prejudice resulting from the extrajudicial enforcement.[248]

(a) The secured creditor obtains possession of the encumbered asset

The frameworks analysed relate, in the main, to non-possessory security; thus, there is no reason to take possession to perfect the security. Taking possession is seen as an initial interim

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244 See Chapter 3 paragraph 3.3.3.10(*a*) (UNCITRAL framework) *supra*.

245 Scottish Law Commission Report 2017 (2) at 138 (recommendation 129) and s 68(4) the Draft Moveable Transactions (Scotland) Bill).

246 Articles 54 and 56 of the Belgian Pledge Act of 11 July of 2013.

247 It is not doctrinally correct to say that the secured creditor 'takes-over' or 'keeps' the assets. Even though the secured creditor already has possession, she 'buys' the assets from the debtor at a fair value. See the clarification in R Brits *Real Security Law* (2016) at 170.

248 Also see s 85 of the Draft Moveable Transactions (Scotland) Bill.

measure,[249] but with the intention of securing possession to facilitate subsequent disposal of the property. Dispossession could be made subject to: (1) the debtor's consent; (2) the possible registration of the enforcement notice in a registry; and/or (3) notice to other secured creditors holding a security right in the same asset. The creditor's right to take possession is *automatic* under the UNCITRAL and EBRD Model Law frameworks,[250] which excludes the need to approach a court for an order authorising the creditor to take possession. In terms of the UNCITRAL framework, possession can only take place: (1) after the secured creditor provides notice of her intention to take possession from the debtor, the grantor, or another person in possession of the asset;[251] and (2) if the debtor (grantor) consents to give the creditor possession both in the security agreement and again before possession is taken. Under the UNCITRAL framework, extrajudicial dispossession cannot take place without consent. However, the EBRD Model Law recommends that a secured creditor should be able to take possession, as a protective measure, *without* the debtor's consent (presumably even before the enforcement notice has been sent).[252] This aspect of the EBRD Model Law may be seen as self-help and is not the approach recommended in this thesis. Conversely, the OAS Model Law requires that an attachment order, using an expedited judicial process, be obtained before the secured creditor may take possession of the encumbered property.[253]

(b) Disposition of the encumbered asset

All the legal frameworks analysed in this thesis recommend that the secured creditor should be able to sell, lease, or license the encumbered asset to a third party without court intervention but subject to specific requirements.[254] In the case of dispossession, one generally requires: (1) the debtor's (or grantor's) consent; (2) the possible registration of the enforcement notice in a registry; and/or (3) notice to other secured creditors with a security right in the same asset. Also, in the case of a private sale, the debtor's consent, and possibly the consent of other

249 To remove the encumbered property from the control of the debtor who can dispose of, neglect, or destroy the property.

250 See Chapter 4 paragraph 4.3.3.6(*b*) *supra*.

251 The UNCITRAL Guide prescribes that the notice should be given in a 'timely, efficient and reliable way' (recommendation 150).

252 See Chapter 4 paragraph 4.2.3.2(*h*) *supra*.

253 See *supra* Chapter 3 paragraph 3.3.3.10(*b*) (the UNCITRAL framework) and 3.3.4.9 (concerning the enforcement of an acquisition security right under the UNCITRAL framework), Chapter 4 paragraph 4.2.3.2(*h*) (with regard to the EBRD Model Law).

254 See *supra* Chapter 3 paragraph 3.3.3.10(*c*) (concerning the UNCITRAL framework), Chapter 4 paragraph 4.2.3.2(*h*) (concerning the EBRD Model Law), and paragraph 4.3.3.6(*c*) (concerning the OAS Model Law).

secured creditors with interests in the asset, is required along with having to obtain an independent appraisal of the value of the movable property.

The above requirements manifest in somewhat different ways in the different frameworks. All the legal frameworks recommend delivery of an enforcement notice containing detailed information, to the debtor. However, only the UNCITRAL framework and the OAS Model Law recommend that the enforcement notice also be sent to other secured creditors with an apparent interest in the encumbered property.[255] Furthermore, both the OAS Model Law and the EBRD Model Law require registration of the enforcement notice in the registry. In other words, both approaches (registration of the enforcement notice and delivery of an enforcement notice) are arguably based on the ideal of informing third parties of this enforcement measure – either through notice to other secured creditors, or through registration of the notice. It appears that none of the frameworks requires the debtor's consent before the *disposition* of the property can take place.[256] In terms of both regional instruments, the debtor is given a period – three days in case of the OAS Model Law and 60 days under the EBRD Model Law – within which to settle the outstanding debt, failing which the secured creditor can sell the encumbered property *without the consent of the debtor*.[257] Moreover, only the OAS Model Law requires *privately*-sold collateral to be subject to an appraisal by a qualified appraiser.[258] The EBRD Model Law only states that an attempt should be made to sell the property at a fair price (thus no direct obligation is placed on the chargeholder in this regard). The UNCITRAL framework contains no mention of establishing a fair value, but requires disposal to be 'efficient, timely and reliable'. Furthermore, only the OAS Model Law recommends that a public sale of the collateral should be publicised in two major publications, which corresponds to the requirement imposed during sequestration or liquidation often encountered in domestic insolvency laws.

(c) Acquiring the encumbered asset in satisfaction of the debt

Most legal systems prohibit the inclusion of a *pactum commissorium* in a security agreement. A *pactum commissorium* would allow the secured creditor to take over the encumbered

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255 It appears that the UNCITRAL framework prescribes that there should be two notices, a notice in respect of the dispossession (recommendation 147) and another relating to disposition (recommendations 148 and 149).

256 However, consent is required for taking *possession* under the UNCITRAL framework.

257 See *supra* Chapter 4 paragraph 4.2.3.2(*h*) (EBRD Model Law) and paragraph 4.3.3.6(*c*) (OAS Model Law).

258 Chapter 4 paragraph 4.3.3.6(*c*) *supra*.

property in satisfaction of the outstanding debt without having to acquire the movable property against a fair value or to account for any surplus to the debtor.[259] A *quasi*-conditional sale is, however, allowed in most jurisdictions in terms of which the secured creditor 'acquires' the encumbered property from the debtor in full or partial satisfaction of the outstanding debt, but at a fair value.[260] Also, the debtor should be reimbursed for any surplus (the difference between the selling price and the outstanding debt) when the property is taken over by the creditor. The UNCITRAL framework and the OAS Model Law include the general option that the secured creditor may take over any encumbered asset in satisfaction of the debt, subject to specific requirements. The EBRD Model Law only contains provisions for taking over an entire enterprise subject to an enterprise charge.[261]

In deciding on the content of the provisions regulating the acquisition of the encumbered asset by the secured creditor in satisfaction of the debtor's debt, there are specific considerations that must be taken into account. The first consideration addresses *when* the parties should agree that it is possible for the creditor to 'acquire' the encumbered property – in the initial security agreement and/or after default. The UNCITRAL framework recommends that the secured creditor should make the proposal to acquire the encumbered assets in partial or total satisfaction of the debtor's debt *after* default.[262] The OAS Model Law makes no direct mention of whether the parties should agree that the secured creditor can take the collateral in payment against the debt only after default.

The second consideration is whether the framework should prescribe a standard and/or method for determining a fair value for the movable property. It is my understanding that the value of the asset could: (1) be determined by an independent valuator; (2) be determined using a fair method agreed to by the parties in the initial security agreement; or (3) where the asset belongs to an industry and the value of the movable property is well-known and transparent, this value will be regarded as a 'fair value'. The OAS Model Law requires that the value of the property must be 'appraised by a single qualified appraiser designated by the secured

259 The validity of a *pactum commissorium* is discussed in Chapter 2 paragraph 2.3.3.3(*d*) *supra*.

260 The prejudice that historically resulted from the prohibition of a *pactum commissorium* is that the secured creditor would sell the encumbered property for a price below its true value.

261 As these provisions are similar to business rescue proceedings, the discussion of the EBRD Model Law is not taken further, apart from acknowledging that the Model Law does not include a general provision which allows taking over other assets which do not form part of an enterprise charge.

262 See Chapter 3 paragraph 3.3.3.10(*d*) *supra*.

creditor'.[263] Conversely, the UNCITRAL framework contains no requirement for appraising the value of the encumbered property, nor does it mention that the property should be acquired at a fair value.[264] However, the secured creditor must send a proposal to the debtor and other persons with a right in the encumbered property setting out the amount of the obligation that will be satisfied when she acquires the asset. It is true that this acquisition takes place subject to the debtor accepting the creditor's proposal, but it is unfortunate that there is no recommendation for the proposal to contain a fair value of the encumbered asset. The absence of a fair value leaves room for prejudice to the debtor if the creditor sells the property below market value.

5.4.7.2 Recommendations for reforming the South African framework

As regards enforcement measures, I first recommend some general requirements, followed, secondly, by more specific recommendations related to the possession, dispossession, and 'acquisition' of the encumbered movable property. In the first place, I recommend that the South African framework should include the general standard that the secured creditor should enforce the pledge in a commercially reasonable manner. It is also recommended that the enforcement provisions in respect of the registered pledge and possessory pledge, as set out *supra*,[265] be incorporated as part of a broader statute on security rights in movable property. The final element of my general recommendation, is that the debtor, the grantor of the security right, or another party with an interest in the encumbered property, should be compensated for the loss they suffer as a result of the failure of the secured creditor to comply with her statutory obligations in respect of the enforcement of the pledge.[266] These statutory obligations should form part of a recommended statute on security rights in movable property.

I turn now to the specific recommendations regarding possession, dispossession, and 'acquisition' of the encumbered movable property. My recommendation is that the debtor should be allowed voluntarily to agree that the secured creditor may take possession of the

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263 See Chapter 4 paragraph 4.3.3.6(*c*) *supra*. The reference in art 59(IV) of the OAS Model Law to obtaining an independent valuation could be interpreted as applying both to a private sale and where the secured creditor 'acquires' the asset in full or partial satisfaction of the debtor's debt.

264 See the discussion in Chapter 3 paragraph 3.3.3.10(*d*) *supra*.

265 See *supra* paragraphs 5.4.1.2 (format of the security device) and 5.4.4 (provisions concerning registration for third-party effect).

266 The recommendation relies on a similar provision in the Scottish Law Commission Report 2017 (2) para 27.45 at 139, 140 and s 69 of the Draft Moveable Transactions (Scotland) Bill.

encumbered asset *after* she has defaulted,[267] subject to: (1) proper notice to the grantor and other parties with interest in the property; and (2) the debtor's consent to the creditor's possession, both in the security agreement and again after default. However, I also suggest that when the debtor refuses to part with the encumbered asset voluntarily, the secured creditor must be able to follow an expedited judicial process similar to that recommended in the OAS Model Law. Accordingly, one should investigate whether an expedited judicial process can be implemented within the confines of the current South African civil procedure law; if not, changes would have to be made in that respect. I do not endorse requiring two separate enforcement notices as to the secured creditor's intention to take possession and then to dispose of or 'acquire' the encumbered property. Instead, one notice should be capable of expressing the intention to take both actions. Furthermore, I do not recommend that the enforcement notice be registered in the pledge registry, but rather that it should be sent to the debtor and other secured creditors with a registered interest in that asset. The enforcement notice should conform to a specific format (eg, clearly set out the recourse that the secured creditor intends to take). Further, any enforcement steps (including taking possession of the encumbered asset) may only take place fifteen business days after delivery of the notice.[268] The enforcement notice must be delivered to the grantor of the registered pledge, the holder of a real right in the encumbered property, and/or a person who holds any statutory obligations in respect of the encumbered asset (eg, the Registrar of the Pledge Registry).[269]

Within the South African context, *parate executie* corresponds to the concept of extrajudicial disposition discussed in the legal frameworks analysed. Currently, *parate executie* can only take place *after* the secured creditor has obtained lawful possession of the encumbered asset. *Parate executie* in respect of movable property remains lawful and constitutionally valid in terms of South African law.[270] As it is generally accepted that *parate executie* does not fit the definition of 'self-help',[271] and provided that one is not dealing with a consumer credit transaction,[272] it is permissible for the framework to sanction *parate executie* clauses in security agreements. However, certain aspects of the *parate executie* process would have to be

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267 Where the debtor voluntarily decides to part with the encumbered asset, there can be no 'legal dispute' so the debtor voluntarily parting with the encumbered should not attract a constitutional challenge.

268 Fifteen business days is suggested to conform to the enforcement provisions in terms of the NCA. See Chapter 2 paragraph 2.6.2 *supra.*

269 The recommendation relies on a similar provision in the Scottish Law Commission Report 2017 (2) para 27.43 at 139.

270 See Chapter 2 paragraph 2.4.5.4(*c*) *supra*.

271 S Scott 'Summary execution clauses in pledge and perfecting clauses in notarial bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' (2002) 65 *THRHR* 656 at 664.

272 See, eg, art 46 of the Belgian Pledge Act of 11 July 2013.

examined and amended. The first concerns the point at which the debtor must consent to *parate executie*. The standard for when consent to *parate executie* should be given must be the same as that required under a *quasi*-conditional sale – a debtor who agreed to the sale in the original agreement should not be permitted to recant her consent to *parate executie* after she has defaulted. The parties should be required to agree on the *method* of execution and determine a fair price *after* default. Where they agreed to a private sale, they should be required to obtain an independent valuation, unless this is not reasonably necessary. Whether it is reasonably necessary should depend on the circumstances, and would be influenced by the nature of the asset – eg, whether the asset is perishable or belongs to an industry where determining the market value is relatively easy. In order to prevent the debtor from unreasonably withholding consent to the execution method and purchase price, where the parties fail to reach an agreement within a specified time (the recommendation is 30 days), the secured creditor should be allowed to decide on the execution method and obtain an independent valuation of the property to determine what a 'fair price' would be.

South African case law draws a clear distinction between a *pactum commissorium* and a *quasi*-conditional sale.[273] As long as a fair value is attributed to the asset that is 'bought' by the secured creditor, and the value is determined *after* the debtor defaults, the secured creditor will be able to take the asset in payment of the outstanding debt, provided that the security agreement includes a clause permitting *quasi*-conditional sale. Furthermore, the current position under South African law is that the debtor is only required to consent to the possibility that the asset may be taken over in the initial real agreement, not again after default has taken place. This current position should be confirmed in a separate statute. Also, it should become a statutory obligation that the *quasi*-conditional sale can only take place subject to obtaining an independent valuation of the fair value of the collateral.

The intended legislation should further include provisions on alternate enforcement measures. For example, if a pledge in respect of intellectual property is applied, the secured creditor must be allowed to license this property to a third party.[274] Another example would include the secured creditor leasing the encumbered property to a third party (subject to a mandate agreement signed by the debtor), and using the proceeds from the rental income to

273 See the distinction made in Chapter 2 paragraph 2.4.5.5 *supra*.

274 The Scottish Law Commission recommended the same alternate enforcement measures in respect of intellectual property. See Scottish Law Commission Report 2017 (2) para 28.18 at 154 and s 76 of the Draft Moveable Transactions (Scotland) Bill.

reduce the debt.[275] Moreover, it should be considered whether interim enforcement measures should allow the secured creditor to 'step into the shoes' of the debtor, so to speak, in order to preserve the value of certain assets.[276] It is already customary for South African financial institutions to reserve a right to exercise voting rights in respect of encumbered shares. Accordingly, including a similar statutory provision in this regard, would result in legislating what is already common practice and the framework should rather facilitate the exercise of reasonable choices by the parties.

5.4.8 Some miscellaneous practical considerations

If the reforms recommended above are to succeed, there must be sufficient buy-in from the stakeholders in the broader credit industry, as well as a commitment from the South African government to embark on a legal reform project. An essential aspect of the success of the legal framework involves establishing the required movable property registry and ensuring that it is and remains operational.[277] The next practical aspect is that the recommendations would have to be translated into a statute, which should ideally be drafted by local lawyers with input from foreign experts acting in an advisory capacity. South Africa is in the fortunate position of being able to draw inspiration from: (1) projects recently undertaken by other law commissions (eg, the Scottish Law Commission); (2) recommendations contained in international and regional instruments (largely those discussed in this study, but others as well); (3) secured transactions law reform projects being undertaken in neighbouring and other African countries and elsewhere; and (4) it is hoped, from the recommendations made in this thesis. Finally, a proper transitional plan would have to be put in place, which should include extensive industry and public consultation, awareness campaigns, and training initiatives before the implementation date of any proposed statute – especially with regard to use of the registry.[278]

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275 The Scottish Law Commission recommended the same alternate enforcement measures. See Scottish Law Commission Report 2017 (2) para 28.14 at 152 and s 75 of the Draft Moveable Transactions (Scotland) Bill. See also the recommendation *supra* Chapter 3 paragraph 3.3.3.10(*c*) (concerning the UNCITRAL framework).

276 For example, the Scottish Law Commission recommended such steps in s 77 of the Draft Moveable Transactions (Scotland) Bill and the Scottish Law Commission Report 2017 (2) at 154, 155. Further, art 51 of the Belgian Pledge Act of 11 July 2013 also include the alternative to lease the encumbered property.

277 The register should be established only after the necessary legislation which would regulate the operation of the register has been adopted.

278 See M Gedye 'A distant export: the New Zealand experience with a North American style personal property security regime' (2006) 43 *Can Bus LJ* 208 at 232, emphasising the importance of extensive educational campaigns.

5.5 Concluding remarks

In this final chapter of the thesis, the elements for the effective legal framework in respect of security rights in movable property were merged to create a foundation capable of inspiring any future South African reform of the legal framework applicable to security rights in movable property. The recommended South African framework is not a detailed exposition of the exact text of a future statute, but rather provides the framework within which a bill on security rights in movable property could be drafted.

By way of a final summary, I conclude the thesis by listing the recommended key policy objectives and fundamental principles. The key policy objectives encompass the general reform goals and I have, therefore, decided to phrase them in terms similar to an appropriate formulation of the long title (or purpose) of a future statute dealing with security rights in movable property. Thereafter, each suggested fundamental principle is listed, followed by a summary of concrete recommendations on how the South African legal framework for security rights in movable property should be reformed to achieve each fundamental principle.

5.5.1 The recommended key policy objectives phrased as a possible long title to a future statute

> 'An Act to create an effective legal framework to enhance access to credit granted on favourable terms; which framework must facilitate the use of any type of movable property as security in the broadest possible sense; where the process to create the security right in movable property must be simple, and promote consistency and certainty; where a proprietary security right in movable property can be created without having to dispossess the debtor; where transparency is promoted by establishing clear publicity rules and predictable priority rules; and which legal framework is aimed at enhancing the efficacy of the enforcement measures while also safeguarding parties' legitimate interests during the course of the enforcement process.'

5.5.2 Recommendations specific to each suggested fundamental principle

By way of summary, this thesis has made the following recommendations as to how to implement each fundamental principle.

A single legal framework to regulate all secured transactions, as far as possible[279]

1. Notarial bonds as a form of real security should be replaced completely, and the current registry system should be disregarded as far as movable property is concerned.

2. A new type of registered pledge should be introduced to be registered over any kind of corporeal movable property (unless expressly excluded) and any type of incorporeal movable property (unless expressly excluded).

3. The nature of the registered pledge should enable the pledge to function as both a static and a dynamic type of security.

4. Title-based security devices should, at least for the present, retain their current format, but with the option of voluntary registration of the rights created in terms of these devices.

A framework with a comprehensive scope, allowing the debtor to use most types of asset to secure any obligation in respect of any category of secured transaction[280]

5. It should be possible to register the security right (as a limited real right) in any type of corporeal or incorporeal movable property unless there is a clear policy reason to exclude a specific asset type.

6. The encumbered asset and the secured obligation should be described so as to 'reasonably allow their identification', which includes using either a generic or specific description.

7. It should be possible to register a security right in respect of future assets.

8. The security right should continue into a mass or a product where the security right existed in a component that now forms part of the mass or a product.

9. The security right should be allowed to extend to property that has been attached to immovable property, subject to adequate publicity having been given in terms of the immovable property register.

A simple process for creating the security right while maintaining a security right that fulfils the essential qualities of a property right[281]

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279 The research question which relates to this fundamental principle asked: 'Does a single legal framework result in an effective transactions law framework?' See Chapter 1 paragraph 1.4.1 *supra*.

280 The research question which relates to this fundamental principle asked: 'How comprehensive (or inclusive) should the scope of the secured transactions law framework be?' See Chapter 1 paragraph 1.4.3 *supra*.

281 The research question which relates to this fundamental principle asked: 'Should the method of creating a security right be revised?' See Chapter 1 paragraph 1.4.2 *supra*.

10. The creation and third-party effectiveness of a security right should take place simultaneously.

Registration in a general registry as the primary method of publicity, while also recognising certain secondary methods[282]

11. A transaction-based filing system should be adopted without requiring that the real agreement be *registered* for public notice.[283]

12. Two separate movable property registries should be created:

- a registry dedicated to capturing: (1) registered pledges; and (2) possessory pledges, but registration of the latter potentially determines its priority ranking, not its creation; and
- a second registry dedicated to capturing title-based security devices, but in which the recording is voluntary and no legal consequences attach to the registration, at least for the present (with the view to possibly making registration compulsory in future).

Priority rules that are transparent and predictable[284]

13. The general rule − first in time is stronger in right − should continue to apply with deviation permitted only for a closed list of exceptions.

14. The priority of the security right in a future asset should be determined with reference to the date of registration, not the date on which the asset materialises.

15. The possibility to determine the priority ranking of a possessory pledge (within the broader meaning intended *supra* [285]) with reference to the date on which the possessory pledge was registered should be examined, although the right is created on delivery (or when cession takes place).

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282 The research question which relates to this fundamental principle asked: 'What is the best method to achieve third-party effectiveness?' See Chapter 1 paragraph 1.4.4 *supra*.

283 Nevertheless, the recommendation includes that a notarised copy of the real agreement must at least be filed with the registry, but it is not available for public access.

284 The research question which relates to this fundamental principle asked: 'How predictable and transparent are the current priority rules?' See Chapter 1 paragraph 1.4.5 *supra*.

285 Paragraph 5.4.1.2(*d*) *supra* including traditional possessory pledges and cession but limited to the pledge construct.

The seller (creditor) should not be permitted to benefit unfairly from using a title-based security device[286]

16. The current title-based security devices should not be changed into a device that is the functional equivalent of an unpaid vendor's charge.

17. The voluntary registration of the right in terms of a title-based security device, should be implemented. Registration might become compulsory in future.

18. The unfavourable position of a buyer under a title-based security device who has paid a substantial portion of the purchase price, should be improved.

19. A prohibition on the unjustified enrichment of the seller under a title-based security device when the seller sells the encumbered upon the debtor's default, should be imposed.

The creditor's enforcement rights must be as broad as reasonably possible[287]

20. The secured creditor should enforce the security device in question in a commercially reasonable manner.

21. An enforcement notice, which conforms to a specific format, should be sent to the debtor and other involved parties before the creditor may take any enforcement steps,[288] and any enforcement steps can only be taken after a period of fifteen business days after delivery of the notice.

22. A court order ought to generally not be required before the secured creditor may take possession of the encumbered property or other interim measures, to ensure that the encumbered property is not disposed of or reduced in value – subject to the debtor having consented both in the security agreement and again after default, that the secured creditor is permitted either to take possession of the encumbered property, or to take other interim measures to preserve the value of the encumbered asset.

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286 The research question which relates to this fundamental principle asked: 'Should there be equal treatment of all creditors providing debtors with credit to acquire movable assets?' See Chapter 1 paragraph 1.4.7 *supra*.

287 The research question which relates to this fundamental principle asked: Is the current South African legal framework concerning the *enforcement* of creditors' security rights the most efficient option? See Chapter 1 paragraph 1.4.6 *supra*.

288 The recommendation relies on a similar provision in the Scottish Law Commission Report 2017 (2) para 27.43 at 139.

23. Before the secured creditor is allowed to proceed to enforce its rights in terms of the security device in question, an enforcement notice must be delivered to the grantor of the registered pledge, the holder of a real right in the encumbered property, and/or a person who holds any statutory duties in respect of the encumbered asset.[289]

24. A court order should not be required either when the secured creditor disposes of or acquires the encumbered property in partial or full satisfaction of the debt, subject to all interested parties having received the prescribed enforcement notice and fifteen business days having passed after delivery of the enforcement notice.

25. Where the registered pledge in respect of corporeal movable property is enforced, the secured creditor should be allowed to lease the encumbered property to a third party, subject to receiving a mandate to that end from the debtor.[290]

26. Where the registered pledge in respect of intellectual property is imposed, the secured creditor should be allowed to license this property to a third party, subject to receiving a mandate regulating the licensing from the debtor.[291]

27. The debtor, the grantor of the real right, or another party with an interest in the encumbered property, should be compensated for the loss they have suffered as a result of a failure by the secured creditor to fulfil her statutory obligations in respect of the enforcement of the security device in question.[292]

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289 The recommendation relies on a similar provision in the Scottish Law Commission Report 2017 (2) para 27.45 at 139, 140.

290 The Scottish Law Commission recommended the same alternate enforcement measures. See Scottish Law Commission Report 2017 (2) para 28.14 at 152 and s 75 of the Draft Moveable Transactions (Scotland) Bill.

291 The Scottish Law Commission recommended the same alternate enforcement measures in respect of intellectual property. See Scottish Law Commission Report 2017 (2) para 28.18 at 154 and s 76 of the Draft Moveable Transactions (Scotland) Bill.

292 The recommendation relies on a similar provision in the Scottish Law Commission Report 2017 (2) para 27.45 at 139, 140 and s 69 of the Draft Moveable Transactions (Scotland) Bill.

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