

Right of Pledge and the Transparency of Debtors' Assets

Name: R.A. Zeldenrust

Number: 0490377

E-mail: R.A.Zeldenrust@students.uu.nl

Date: Januari 2011

Supervisor: Mr. J.M. Milo

Master Law & Economics

Utrecht University



Universiteit Utrecht

Contents

Title page.....	P.	1
Contents.....	P.	2
1.1 Introduction.....	P.	4
1.2 Research question.....	P.	5
2 The economic function of the transparency of assets; economics of trust and the market for lemons.....	P.	6
2.1 Transaction costs.....	P.	7
2.2 False wealth doctrine.....	P.	11
2.3 Market for lemons.....	P.	12
3 Legal analysis and historic development.....	P.	15
3.1 Right of pledge; registration requirements.....	P.	15
3.2 Right of pledge.....	P.	22
3.3 Register of the rights of pledge.....	P.	23
3.4 Security rights.....	P.	24
3.5 Publicity.....	P.	24
3.6 More than one right of pledge on the same good.....	P.	26
3.7 Change in ranking; race for priority.....	P.	27
3.8 Description of the encumbered assets or claims, how specific?; identifiability.....	P.	28
3.9 Enforcement of the right of pledge.....	P.	30
4 Economic theory applied to the legal analysis.....	P.	31
5 Privacy and access to a Register of rights of pledge.....	P.	32
6 Comparative legal analysis.....	P.	33
6.1 The US, UCC chapter 9; filing.....	P.	33
6.2 Model law.....	P.	34
7 Effective Enforcement of Judgments in the European Union: the Transparency of Debtors' Assets.....	P.	42
7.1 Debtors' Declaration.....	P.	43
8 The right of pledge in practice.....	P.	44
9 Conclusion.....	P.	46
References.....	P.	49

Annex A.....	P.	53
Annex B.....	P.	54

1.1 Introduction

What happens if a company goes to a credit facilitator and asks for a credit? The credit facilitator wants to investigate the creditworthiness of the potential debtor. First, the annual reports will be sifted out for e.g. the position of the capital and the profitability of the company. The legal investigation starts with how many assets does the potential debtor own. Is there any property or real estate? Are there claims to third parties? The next step is investigating under which conditions the financing can be offered and second in which way collateral may be used. Is the real estate encumbered with a mortgage? Are the assets and claims encumbered with security rights? The credit facilitator will start to search in registers and besides that he will do some inquiries. If the credit facilitator thinks that there is enough potential and enough room to secure his credit with security rights, he will then finance the debtor. The secured creditor will establish a security right on the assets or claims of the debtor and he will think that his credit is safe and secured. But maybe after a short period, business will not go as good as hoped for at the time of the request for credit by the debtor and the debtor may go into an insolvency. If this happens, the debtor will not be able to pay the credit of the creditor any longer. The secured creditor is maybe surprised or expected this, but the creditor has his right of pledge on several assets. The secured creditor wants to enforce his right and claims the assets in order to execute the assets. This way he will have some proceeds to cover the losses made on the granted credit. Suddenly other creditors of the debtor appear. The other creditors are claiming the assets as well and are claiming that they have older rights of pledge than the last creditor. After looking into the several deeds of rights of pledge of the parties it turns out to be that the other creditors are right. The last creditor is third in rank in recovering his debt by having a right on the proceeds of the execution of the assets. The right of pledge of the last creditor turns out to be worthless. Also in case a second non-possessory right of pledge is established by a second creditor and turned into a possessory right of pledge, it will rank first if the second right of pledge holder acted in good faith, if he was allowed to believe that he was the first right of pledge holder.¹ We can state that research in the register of the Chamber of Commerce is not sufficient since there is no duty for debtors to lay down previous creditors or security rights or a duty to disclose which assets are

¹ Art. 3:238 para 2 BW

encumbered. The last creditor remains with a huge loss and has to suffer. This situation is acknowledged and therefore has currently given rise to the legal discussion on publicity and registration of rights of pledge.

1.2 Research question

The above mentioned problem leads to the following research question:

Is there a need to introduce a Register for rights of pledge and will this lead to an increase in the transparency of debtors' assets?

The outline of the paper is as follows. First, I will introduce the economic theory about rights of pledge and the transparency of rights of pledge. Second, I will discuss the legal aspects and history of a right of pledge and problems with rights of pledge. Third, I will apply the economic theory on the legal analysis. Fourth, I will discuss privacy issues. Fifth, I will discuss comparative legal analysis, in particular the situation in the US. Sixth, I will discuss the green paper of the European Commission on the transparency of debtors' assets. Seventh, I will discuss the right of pledge in practice and in what kind of situations it is used. In the last chapter I will conclude with a summary and the answer on the research question.

2. The economic function of the transparency of assets; economics of trust and the market for lemons

The economy functions around a complex set of rules. These rules have to be fulfilled for a proper functioning of the market. Proper functioning of the market is a basic condition for a stable economy. Financial markets and especially the market for credit forms a special but crucial submarket in the range of economic markets. I will discuss the economic analysis by making use of three economic main theories: first the theory about transaction costs, second the false wealth doctrine and third with the market for lemons-theory.

A right of pledge works as a credit multiplier in the economy. Almeida and Campello showed that the tangibility of assets has an important impact when firms face credit constraints.² The sensitivity of investment-cash flow are increasing to the degree of tangibility of constrained firms' assets. The tangibility of assets determines the access to credit, so companies with tangible assets have greater access to external funds. Companies with more tangible assets can more easily establish a right of pledge on assets. Because of credit imperfections companies with small tangible assets have more difficulties in finding access to credit. Access to credit has an impact to investment behaviour of the company. It is predicted that the sensitivity of investment spending to cash flow increases with asset tangibility.³ Through research with a sample of manufacturing companies/firms Almeida & Campello found a strong connection between asset tangibility and investment-cash flow sensitivities. This effect is only strong for companies which face credit constraints; the effect ceases to exist for unconstrained companies. The findings of the researchers were based on calculations on data from the database and are in line with the theory. Companies with more tangible assets are less likely to be financially constrained. So a good functioning system of rights of pledge in combination with tangible assets of companies functions as a credit multiplier for corporate investment.

² Almeida, H. and Campello, M. 'Financial Constraints, Asset Tangibility, and Corporate Investment', *NBER Working Paper Series*, 2006.

³ Idem.

2.1 Transaction costs

For the proper functioning of the market it is essential that information is available and transaction costs are low. Transaction costs are the costs of exchange.⁴

There are three steps involved in the exchange.

First an exchange partner has to be searched and found. Second there has to be a successful bargain between the exchange partners. Third step is an enforcement of the bargaining. This leads to three types of transaction costs: search costs, bargaining costs and enforcement costs.

First, the consequences for search costs. If a right of pledge has to be registered in a public register this will lead to a decrease in search costs. The decrease in search costs is the effect of finding a valuable exchange partner sooner. Credit facilitators are faced with lots of entrepreneurs and requests for credits. The credit facilitator has to search in the annual reports for security rights given to other parties. The credit facilitator has to contact the other credit suppliers of the requesting company like other banks and financial institutions if he wants more information about other rights of pledge. At last, the credit facilitator has to ask the credit requester for example to fill out a form about the given security rights or to provide a written statement. This process is not institutionalised so every credit facilitator follows his own routine. This process is very time consuming and it is open to fraud. The result of this route can be that the credit requester has given all his assets and claims as a right of pledge to other credit institutions. When a public Register for rights of pledges is introduced, credit institutions will be able to check this Register. This will decrease the search costs because fewer steps have to be made to find out if the exchange partner is creditworthy.

Second the consequences for bargaining costs. The introduction of a public Register for rights of pledge will lead to a decrease in bargaining costs. Negotiations are complicated when there is lots of private information and threat values are unclear. "Bargainers are more likely to cooperate when their rights are clear and less likely to agree when their rights are ambiguous."⁵ The bargaining process will be shorter because it is public which rights of pledge has been given and to what extent new

⁴ Cooter, R., Ulen, Th, *Law & Economics* (4th ed.), 2004.

⁵ Cooter, R., Ulen, Th, *Law & Economics* (4th ed.), 2004, p. 93.

rights of pledge can be given and on which assets or claims. It is easier to check which assets or claims are left over to encumber and which ranking they will have in selling off someone's goods in case of insolvency. The threat values are more properly defined and more public. The threat values are determined by the rights of the parties in legal disputes. Simple and clear systems are the best solution to have public and reliable thread values. The system of public registration of landownership and mortgages creates more legal certainty and thereby avoids many disputes. Also the possession of goods and the use of goods is easy to check and therefore is in principle coherent and in relationship with ownership. Moreover the classical possessory right of pledge is a simple and clear criterion in the settlement of disputes and therefore avoids many disputes. Similarly the introduction of a register for rights of pledge is a simple and clear criterion in the settlement of disputes and therefore avoids many disputes. Because of the simple and clear criteria thread values are open and bargaining becomes less costly and less difficult. Confirmation of having a right of pledge is easy. Of course the legislator and the authorities have to weight the administration costs and burden against the benefits of a simple and clear system of security rights. There should be a balance between the cost and benefits but in principle the law ought to favour criteria that are clear and simple.

Third, the consequences for enforcement costs. The introduction of a registration system of rights of pledge will decrease the enforcement costs. Enforcement costs for complex transactions are a more serious issue than for simple purchases. It takes time to fulfil an agreement. "In general, enforcement costs are low when violations of the agreement are easy to observe and punishment is cheap to administer."⁶ Because of the time frame of the agreement the default or tort can sometimes only be discovered at the end of an agreement. For example, when an employee commits fraud or bribery in his task and violates his labour contract, the violation of the agreement is hard to discover, and not easily observed and sometimes difficult to punish. In case of an agreement to have a non-possessory first right of pledge on some of the assets, violations of the agreement are not so easy to observe and punishment is costly to administer. The violation of an agreement to have a non-possessory first right of pledge is often only discovered at the end of a legal

⁶ Ibid.

relationship when for example the debtor is in an insolvency and suddenly an earlier right of pledge deed shows up.

It is possible that the rights of pledge are mentioned in the annual report but it is also possible that they aren't. Maybe the entrepreneur wasn't aware of the situation, because he didn't read the general conditions of his bank credit when he arranged the credit decades ago. At the time of arranging the old credit decades ago it was not mandatory to mention the right of pledge on assets in the annual report. Punishment is costly because the only way to punish the debtor is to terminate the agreement and the financing or to file a lawsuit against the debtor. Considering the nature of the agreement and the position of the debtor when the violation of the right of pledge-contract is discovered the debtor is often in a bad financial position because it is usually in the stage of insolvency. In those situations there is not much equity left to recover damage and loss. In lots of cases creditors will decide that it is not worthy to punish the debtor for violating the right of pledge contract others than that the debtor is declared bankrupt.

Redistribution theory

Arranging a new secured credit could facilitate the redistribution of wealth from unsecured creditors to secured creditors.⁷ If a new credit is granted with a right of pledge on assets, the creditor has priority over the assets over other old unsecured creditors. In first instance the old creditors can take a part in the proceeds of all sold assets in case of execution by insolvency of the debtor. After the arrangement of a new secured credit by the debtor, the old creditors have only the right of a part of the proceeds of lesser assets. Of course the shifting in wealth is in an expected-value sense if assets are executed. Unsecured creditors can adjust the terms of their credit, but not all unsecured creditors are in the position of adjusting the terms or interest rates. Because of this threat creditors ask for rights of pledge on more assets than necessary and the outcome is that debtors grant rights of pledge on too much assets.⁸ The empirical studies however don't always support this theory, because companies with many non-adjusting creditors like tobacco companies don't have

⁷ Armour, J., 'The Law and Economics Debate About Secured Lending: Lessons For European Lawmaking?' in Horst, E. Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

⁸ Idem.

more secured credit/debt than the average companies. In the empirical study the unsecured creditors are tort victims which become creditors of the tobacco companies. However tort victims are not regular creditors so it is a little far-fetched to use this as a good example of the theory.

Signalling theory

The offering of a right of pledge on certain assets can be used to signal to the creditor. In the signalling theory the debtor wants to signal to the creditor that he is a serious party. The right of pledge on assets or claims can be seen as a hostage. Better debtors can offer the right of pledge against lower costs and worse creditors have higher costs to offer the right of pledge predicts the theory. In this signalling theory costs are seen as losing the asset and the risk of losing the assets is bigger for worse creditors. Armour argues that from the debtors point of view there is no difference in secured or unsecured credit because in case of insolvency the assets will be seized by creditors whether or not the credits were secured or unsecured.⁹ The benefit of a right of pledge in case of insolvency is not against the debtor but against other creditors. Therefore Armour argues that the costs for a debtor of offering a right of pledge are decreasing when the probability of default or getting in insolvency is increasing. This is in contradiction with the signalling theory. The aspect that Armour didn't consider is that a secured creditor with a right of pledge can also enforce his right when there is no insolvency, but when the debtor does not perform. When a secured creditor with a right of pledge enforces his right and seizes the assets, this is bad for the reputation. A deteriorating of the reputation is worse for debtors with a good reputation (better debtors) than for debtors with a worse reputation (worse debtors). This effect implies that in this case more costs are made by the better debtor. Further it can be argued that the cost of offering the right of pledge is less costly for the better debtor when the deed of right of pledge is signed, because the compiling of a list of assets at the closing date and in later sending dates is less costly for the better debtor. The aspect that it is less costly to compile a list of assets or claims for the better debtor is because better debtors usually have a better and up-to-date bookkeeping. To conclude there are several arguments pro and several arguments contra the signalling theory.

⁹ Idem.

Theory of monitoring and bonding

Further the right of pledge can be used as an instrument to improve monitoring. Secured creditors can demand that the debtor has to hand in his figures and a list of assets in stock every quarter of the year. Also the secured creditor can send an inspector who can inspect whether or not the assets are in the possession of the company and placed on the belongingness of the company.

Further debtors can engage in risky projects after a credit is granted by the creditor. There can be a conflict of interest between the debtor and the creditor after granting the credit. In the principal agent theory the debtor can be seen as the agent and the creditor as the principal. The agent has an incentive to engage in risky projects because the high profits are for the agent/shareholders and the cost in case of a failure is for the creditor. The right of pledge can prevent this because the debtor has for example the contractual obligation to send in every month a list of the assets and claims. Hereby activities of the debtor will be better monitored. Further, the debtor is bond to keep the assets and not to sell them in exchange for more risky business ventures or objects. Financing of more risky projects is becoming more difficult because new creditors can not be offered full security. It forces new creditors to investigate and closely look at the new ventures and activities and the profitability of the ventures they fund.¹⁰ It is clear that a right of pledge helps to ease the principal-agency issue of the creditor.

2.2 False wealth doctrine

Another theory of a transparent system of rights of pledge is the false wealth doctrine.¹¹ The false wealth doctrine means that the ostensible assets by party A can mislead party B that party A is owner of the assets. Non-transparency leads to misleading presentation of richness. The creditor can give the debtor a financing on his false assumption that the debtor is rich, or has enough assets. The assets in the power of the debtor do not represent his richness but gives a false representation of his wealth.

¹⁰ Idem.

¹¹ Struycken, T.H.D. 'De beteknis van het Anglo-Amerikaans zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code; over bepaaldheid en publiciteit', *Ars Aequi*, number 5, 1998.

In a world with only a possessory right of pledge it would be easier to see if a party was rich based on his assets. If a right of pledge was established the debtor had to be disposed of his assets. “The debtor’s dispossession fulfils two major functions: it makes it more difficult for the debtor to dispose of the pledged goods to a third person; and the debtor can no longer create the misleading impression in the minds of his other creditors of owning the pledged goods which might be available for the satisfaction of their claims.”¹² The false wealth doctrine is an old theory which can be questioned nowadays, because it is more common for companies to have a credit and not to finance all activities by themselves. Of course for this credit it is most common that the credit is secured. It depends on the branch how common it is that rights of pledge are given. In some business areas like café’s and automobile industry it is very common to give a right of pledge on all assets and this is widely known. In those areas most credit facilitators know that potential debtors have assets in their possession that don’t represent their wealth position.

On the other hand the current situation could also be characterised as a false poverty doctrine. Everyone expects that a company in a certain branch has no assets free of right of pledge or other security rights because that is the general situation. A company which has financed all his assets by himself is hindered by this opinion because the company has potential assets which could be used for a right of pledge or is a more reliant customer of expensive assets. Whether or not the contemporary situation can be characterised as one of false wealth or false poverty is not the most important issue. However this is an argument for the introduction of a Register of rights of pledge. In the new situation after the change it will be more clear which assets of a company represents the richness or poverty of the company. At the same time full ownership of the assets is not important for the profitability of the company.

2.3 Market for lemons

In economics trust is a key element for prospering growth and welfare in a country. By establishing a right of pledge the creditor has to trust the other party in the sense that the credit requester has revealed the truth and will do his best to fulfil the agreement. The right of pledge is one of the types of security rights. “Security rights enhance the probability that a creditor will receive repayment of his loan, particularly

¹² Hartkamp, H., Hesselink, M. Hondius, E. Joustra, C. Du Perron, C. Veldman, M. (eds.) *Towards a European Civil Code* (5th ed.), 2004.

in the event of insolvency.”¹³To reward the right of pledge giver, usually the debtor receives a discount on the charged interest rate by the creditor. The market for secured credit and the right of pledges is a market with asymmetric information. In a market with asymmetric information there is a situation in which a buyer and a seller possess different information about a transaction. The potential debtor knows more about his financial situation and the security rights he has given to other parties than the credit facilitator does. A market for lemons will appear when only the bad contracting parties are left on the market and the good contracting parties will leave the market.¹⁴ If a market is confronted with too many bad contracting parties the price of the service of the agreement will increase to cover the risk. Good contracting parties will consider the price too high and leave the market to arrange the service of the agreement in another way or will stop their business. When some of the good contracting parties are leaving the market there will be more bad contracting parties left over. The risk will increase; the price will increase as well and more good contracting parties will leave the market. This cycle will repeat itself a couple of times and in the end there are no good contracting parties left at all. The supplier of the service will increase the price and in the end will stop because it has become too costly, or the supplier will end up insolvent and the market will disappear. The market ceases to exist.

In the market of supply of credit in exchange of a non-possessory right of pledge this will lead to the following: Financial credit facilitators are confronted with higher risk because of more bad debtors. In reaction to the higher risk the credit facilitators will increase the interest (the spread between the market interest and the interbank interest or euribor rate, risk premium). The higher interest will lead to the situation that some good credit demanders leave the market because they consider the price too high. Because the good-quality demanders leave the market, the financial credit facilitator is confronted with more bad requests for credit. In reaction the credit facilitator will raise the interest rate with the consequence of more good credit requesters leaving the market. In the end only the bad credit requesters will be left over and the interest rate will be very high because of the large risk premium. A

¹³ Kieninger, E. (Eds.), *Security Rights in Movable Property in European Private Law*, 2004, P. 7

¹⁴ Pindyck, R.S. and Rubinfeld, D.L., *Microeconomics* (6th ed.), 2005.

solution in the normal market to this problem is signalling. Suppliers of the product can give a signal that the product is of real good quality by giving guarantees or building a good reputation. For products like health insurance there is government intervention and also the market for rights of pledge and credit should be intervened by the government.

Eastern states in Europe in transformation

Will a country gain by a clear system of security rights in general and a register for rights of pledges in specific? Other countries in eastern Europe had a development of security rights and introduced a Register.¹⁵ Especially poor countries gain from a well functioning property and contract infrastructure. Secured credit is also important for developed countries like the US where overall secured credit has been estimated at \$1.8 trillion.¹⁶ It is estimated that 40% of the credit is secured. In poorer countries but also in medieval Europe, creditors have and had to rely on hostages and reputation. In modern Europe we have the institutional framework of security rights and more specific the right of pledge. The linchpin of a functioning credit system is the non-possessory right of pledge.¹⁷

It is important for states in transformation, like the eastern states, to have a well-functioning right of pledge system and it requires the following elements. "A good quality of secured transactions law, clear allocation of property rights, non-arbitrary enforcement of contracts, functioning and non-corrupt courts and registers or other systems of notice, and a political environment which gives lenders faith that these arrangements will outlast the terms of the credit."¹⁸ Such reform has costs and benefits. The benefits are improved lending terms and the possibility of long term credits. The costs are the transaction fees and registration entry costs and the costs of identifying the assets. Small and medium companies are about to win in this situation. There are also people who will lose in the reform and those are heads of privatized monopolies in former communist countries and notaries in certain countries. Even judges and the judicial hierarchy can lose some of their power because secured credits and rights of pledge can now be enforced in more cases

¹⁵ Cadwell, C., Meagher, P., 'Collateral Law and Economic Transitions', *Economic Reform Today*, Number 1, 1996.

¹⁶ Idem.

¹⁷ Idem.

¹⁸ Cadwell, C., Meagher, P., 'Collateral Law and Economic Transitions', *Economic Reform Today*, Number 1, 1996, pp. 24.

without the help of judicial power. A registration system with a strong position of notaries for the authentication and record keeping may contain fees for notaries of more than 5% of the amount of the secured credit.¹⁹ Notaries in those states could lose a lot with the introduction of an open public register of rights of pledges like in the US. The US system uses a more simple form as will be discussed later. Law and legal professionals have to facilitate commercial transactions and should not be most concerned about legal doctrines. A transition to a new system will not always go smoothly. Short after the introduction of the system it is possible to monitor the credit more effectively. This can lead in the short term to more insolvencies. In the long run a successful improvement of the system of security rights will lead to the expansion of credit markets, more possibilities and encouragement of foreign and domestic investors and more growth.²⁰ Further the possibilities of fraud are more limited. From the point of view of the unsecured creditor the introduction of a public Register is not so attractive. Unsecured creditors have no benefits of a public Register since they will be excluded.

3 Legal analysis and historic development

3.1 Right of pledge; registration requirements

The law in the Netherlands has a systematic structure for the requirements to establish a right of pledge. As stated in Art. 3:84 BW the transfer of asset has the requirement of a delivery on a legal ground. With the legal ground the asset should be described specific enough as stated in para 2 of Art. 3:84 BW. The same rules for the transfer of an asset holds for the establishing of a right of pledge because Art 3:84 BW is linked to Art. 3:98 BW. Further requirements for the establishing of a right of pledge are given in Art. 3:237 BW and 3:239 BW. Here it is stated which requirements have to be fulfilled to establish a valid non-possessory right of pledge. This can be done by way of a deed of right of pledge by a notary or by way of a secret/private deed of right of pledge which is registered in a non public way by the tax authorities. A requirement which in practice is often not fulfilled, is the requirement of the right of pledge giver, to give a statement in the deed of right of pledge that he is authorized to establish a right of pledge on the assets and further

¹⁹ Cadwell, C., Meagher, P., 'Collateral Law and Economic Transitions', *Economic Reform Today*, Number 1, 1996.

²⁰ *Idem*.

that the assets are not encumbered with any other security right, or in case the assets are encumbered, by which security right the assets are encumbered. (Art 3:237 para 2).

After 150 years of transfer for security without publicity, the legislators forbade the transfer for security in 1992.²¹ The non-possessory right of pledge was introduced. After the non public registration and specificity reform there was a stormy development in the law along the judgements in case law by the courts. Many judgements followed up. Hereby a distinction has to be made between the right of pledge on assets and the right of pledge on claims. The provisional end of the development is in 2002 when the Supreme Court in the Netherlands decided that if the asset in the deed of right of pledge is not specifically described, for the specification/specifiability parties have to look at the contractual relationship between the right of pledge giver and the right of pledge holder.²² It is sufficient enough when the deed of right of pledge contains information that at the time of enforcement can be determined which assets are encumbered. So in the case of a right of pledge on copyright/royalties on software it is sufficient enough to mention the name of the software and it is not required that further technical details or characteristics or further specific information are described in the deed. In this Supreme Court of the Netherlands case, the legal ground of the transfer was a legal relationship between the parties and a contractual requirement of establishing a right of pledge.²³ The application of the Haviltex criterion led to a more general interpretation of the relationship between parties and has the consequence of determining the relationship on the sense which parties, under given circumstances and reasonable thinking, can give to each other by acts and statements. Also based on the reasonable expectations of the parties based on the acts and statements at the time of establishing the right of pledge.

In an earlier case about the right of pledge on claims the Supreme Court in the Netherlands decided that identifiability of claims can be fulfilled with the instrument of

²¹ The old BW was from 1838

²² HR 20 september 2002, *NJ* 2002, 610, (*ING/Muller q.q.*).

²³ HR 20 september 2002, *NJ* 2002, 610, (*ING/Muller q.q.*).

computer lists.²⁴ (identifiability is the translation of the Dutch provision 'bepaalbaarheid')²⁵ The computer list of the claims doesn't have to be enclosed by the deed of the right of pledge. In Art 3:84 para 2 jo art 3:231 para 2 BW it is stated that the claim has to be sufficient identifiable or could be explained or interpreted as identifiable eventually afterwards with the information of the deed of the right of pledge. In the deed of right of pledge reference has to be made to the computer list and preferable should contain some information of the computer list such as: the first and the last claim of the list with the name of the debtor and the number of the invoice, the total amount of the claims of the computer list, the date of the creation of the computer list and the number of pages of the computer list.²⁶ A generic description of the encumbered claims of the right of pledge is not an obstacle to establish a valid right of pledge.²⁷ An example of a generic description is "all at the time of signing of the deed of right of pledge existing rights or claims against third parties" and "all rights and claims against third parties which will be acquired out of existing legal relationships with third parties at the time of signing of the deed of right of pledge." For the specification or identifiability of the encumbered claims the trustee or other party has to look at the bookkeeping of the pledge giver. A generic description and a lack of further specification of the claims does not reject the meeting of the requirement of sufficient identifiable/identifiability as stated in Art. 3:84 BW.²⁸ The right of pledge holder has to bear in mind that a right of pledge on assets is not the same as a right of pledge on the proceeds of the assets, when the assets are actually sold by the right of pledge giver but with consent of the pledge holder.²⁹ Even in the case that the third party pays to a bank account where the right of pledge holder has the right to settle/adjust on all claims, this does not mean that the right of pledge holder can actually settle/adjust in the event of the insolvency. So a right of pledge holder has to choose between three options if he wants to prevent such a debacle. First, the option where the right of pledge holder could have a right of pledge on the claim of the third party debtor (purchaser of the assets) with giving notice to the third party. Second, the option of a contract between secured creditor

²⁴ HR 14 oktober 1994, NJ 1995, 447 (*Stichting Spaarbank Rivierland/Gispén q.q.*).

²⁵ Struycken, T.H.D. 'De betekenis van het Anglo-Amerikaans zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code; over bepaaldheid en publiciteit', *Ars Aequi*, number 5, 1998 pp. 75.

²⁶ HR 14 oktober 1994, NJ 1995, 447 (*Stichting Spaarbank Rivierland/Gispén q.q.*).

²⁷ HR 20 september 2002, LJV AE7842 (*Rabobank/Mulder q.q.*).

²⁸ HR 20 september 2002, LJV AE7842 (*Rabobank/Mulder q.q.*).

²⁹ HR 23 april 1999, NJ 2000, 158 (*Rabobank/Wollie*).

and debtor containing a clause that purchaser had to pay to the secured creditor. Third, the option to transform the non-possessory right of pledge into a possessory right of pledge or giving notice to debtors of the claims and to sell the assets by the right of pledge holder with the proceeds on the bank account of the right of pledge holder. In practice the last option is the most popular one amongst credit facilitators.

In the case of two secured creditors with rights of pledge it may be that the first right of pledge holder has a right of pledge on a claim which is lesser detailed and specified due to time. This lesser specificity of the encumbered claim of the first right of pledge does not hinder the establishing of this right of pledge.³⁰ Also the fact that the legal ground was not the same at the time of establishing the right of pledge namely a two party agreement instead of a three party agreement, will not be an obstacle that the right of pledge on the claim was validly established.³¹ In another case it was quite rightly decided by the Court that the right of pledge from an object financier did not embrace movables which were not financed.³²

It was the intention of the legislator in the proposal for a new Civil Code to have a strict system for rights of pledge with attention for publicity and specificity. The judgements of the courts led to relaxing the requirements of publicity and specificity.

Historic development

The Romans already had a right of pledge.³³ The possessory right of pledge called *pignus* could be established on real estate/property and on assets, but only on existing and not on future real estate and assets. The only way to have a right of pledge on future assets in the time of the Romans was to establish an *hypotheca*.³⁴

In 1947 Meijers got the task to make a draft for a new Civil Code. The original idea of Meijers was to forbid the transfer for security and to have a register for the rights of pledge for movables. The transfer for security was common practice in those days

³⁰ VZr. Rb. Leeuwarden 28 oktober 2009, *LJN BK2026 (Speksnijder/Z)*.

³¹ VZr. Rb. Leeuwarden 28 oktober 2009, *LJN BK2026 (Speksnijder/Z)*.

³² VZr. Rb. Utrecht 1 september 2004, *LJN AQ9866 (Rabobank/RC Financial Services)*.

³³ Zwalve, W.J. 'Over generale en bijzondere zekerheidsrechten', *Ars Aequi*, Volume 55, 2006.

³⁴ *Idem*.

before the introduction of a new civil code. The transfer for security implied that by financing an object, ownership of the object was transferred to the creditor as security for paying the credit. The proposal was a register for the rights of pledge. It implied a right of pledge on movables where the good remained in the power of the right of pledge giver and whereby the deed of the right of pledge would be entered in a public register.³⁵ The bill for a register for rights of pledge never went into force, because the parliament made objections. The main reason was that the register for rights of pledge would cost too much of an administrative burden. Non public registration was introduced and it mainly prevented backdating. At the time the Dutch Civil Code was renewed internet did not exist and neither was there a common use of computers. The administrative burden when a Register for rights of pledge would come into force was therefore in that time much higher than it would be nowadays. In the Netherlands, a public register for mortgages and real estate exists. In this register, called the Kadaster, parties can search on the internet when they pay a certain amount and have a password. The administrative burden to look and search in the register is low.

The requirements to establish a right of pledge on an asset are the same as the requirements for the transfer of the asset. This means an act which satisfies the formalities, a legal ground and the authority of the pledge giver to encumber the assets with a right of pledge.³⁶ A side step: For the transfer of an asset, the asset has to be individualised. If someone buys an espresso machine, the espresso machine has to be individualised before transferred and brought into the power of the buyer. This can not be done by the announcement that one of the espresso machines of the stock of ten espresso machines will be transferred. The same holds more or less for the establishing of the right of pledge.³⁷

The encumbered assets of the right of pledge have not to be individualised, but have to be identifiable. The deed of the right of pledge has not to be bipartite, so the deed has not to contain a statement that the right of pledge holder accepts the right of pledge. The accepting of the right of pledge holder is free of form so this could be also verbally.

³⁵ Stein, P.A. (eds), '10.10 Eerst bezitloos pandrecht, daarna vuistpandrecht op dezelfde zaak gevestigd bij: Burgerlijk Wetboek 3, Artikel 238', *Groene Serie Vermogensrecht*, 2009.

³⁶ Mierlo van, A.I.M., 'Zekerheidsrechten', in Van Mierlo & Van Velten (eds.), *Asser/Mijnssen*, 2010.

³⁷ Kortmann, S.C.J.J., 'Meijs q.q./Bank of Tokio – Mitsubishi', *Ars Aequi*, Number 10, 2002.

With the act which satisfies the formalities is meant the agreement/contract between the parties in which it is arranged that a right of pledge will be established and also the deed of right of pledge in combination with the act of establishing. For the closing of the agreement/contract there has to be a consensus of wills between the parties. The formal requirements are the same as for delivery of the assets, for assets the transfer of possession is required, or an authentic or registered private deed (Art. 3:236 para 1 and 2 jo 3:98 jo 3:237 para 1 jo 3:239 para 1 BW). For the validity of the transfer of the asset a valid legal ground is required, by which is meant the legal relation/contract between the two parties in which the establishing of the right of pledge is obliged. In case of a credit facilitator this is often a offer for credit or a signed credit contract. The last requirement for a valid transfer of the asset is the authority of the right of pledge giver of the disposal of the asset. If the right of pledge giver is not authorized to encumber the assets, like for example in the case of a right of retention of the producer of the asset, there is not established a valid right of pledge on the assets.³⁸

Only the holder of a right of pledge is protected against a non authorized disposal of a right of pledge giver, in case of good faith at the time of getting a possessory right of pledge on the asset (Art 3:238 para 1 and 2 BW). The protection of good faith is only valid in case of a possessory right of pledge. In case of more than one secured creditor with all non-possessory right of pledges, the secured creditors do not always know the existence of other non-possessory rights of pledge.

Secured creditors always try to transform the non-possessory right of pledge in a possessory right of pledge in the short time before an insolvency and the trustee arrives and consequently plead on good faith. This way of acting of the secured creditors can be seen as a 'race for priority' and will be discussed in detail later. The holder of a right of pledge on claims is in principle not protected for a non-authorized disposal of a right of pledge giver. There is only one ground for a good faith acquiring of a right of pledge on claims. It is the reason when an unauthorized right of pledge giver is the consequence of a lack of a legal ground by an earlier transfer of the claim (Art 3:88 BW). But the right of pledge holder can only plead on this ground if the

³⁸ Mierlo van, A.I.M., 'Zekerheidsrechten', in Van Mierlo & Van Velten (eds.), *Asser/Mijnssen*, 2010.

requirement of Art 3:239 para 1 is satisfied, which contains the requirement of notice to the debtor of the encumbered claim and when the pledge holder acted in good faith at the time of giving notice to the debtor of the encumbered claim.³⁹

A right of pledge on claims can be established on a future claim (Art 3:231 para 1 BW). Therefore it is required that the claim is sufficient identifiable (Art 3:231 para 2 BW). This is independent of the fact if there exist any legal relationship between the parties of the claim at the time of establishing the right of pledge. The requirement of identifiability is sufficient satisfied if at the time of execution can be determined which claims are encumbered. If it is not clear how far the right of pledge is reaching, for the requirement of identifiability parties have to look at the contractual relationship between debtor and creditor and an explanation of the valid title. Banks often use a special clause to satisfy this criteria which is called a book clause. In this clause it is stated that the bookkeeping of the creditor, without evidence of the debtor, is leading in the determination/identification of the encumbered claims.

The right of pledge can be established for different reasons. The credit security is established for the bank in exchange for credit, the banksecurity is established for the bank, but there is no obligation to grant a credit.

The right of pledge can only be established on an asset which is not a register asset/good as followed from Art. 3:227 para 1 BW. The holder of the right of pledge has priority over other creditors. The pledge holder has the authority to sell the assets without the requirement of an authorization of a judge. The only requirement is that the debtor is in default (Art. 3:248 para 1 BW). The creditor is than able to recoup the due amount on the proceeds. A right of pledge can in principle be established on future goods (Art. 3:97 para 1 jo Art. 3:98 BW). Of course the right of pledge on future goods is only possible by a non-possessory right of pledge. The right of pledge on future claims can be established in the form of a deed. Thereby the claims have to be sufficient described or identified. Notice has to be given to the debtor of the claim unless the right of pledge is established in the way of Art. 3:239 para 1 BW. This can only be done with claims which will arise out of existing legal relations. A right of pledge has to be established as security for a claim, but the

³⁹ Idem.

amount of the claim has not to be determined at the time of establishing the right of pledge. The debtor can demand a written statement about the nature of the claim and if possible the amount of the claim for which the right of pledge is established for.⁴⁰

3.2 Right of pledge

Establishing a right of pledge is done differently every the member state of the European Union. In the Netherlands there are two types of rights of pledge which can be created in three different ways. The two types are: the possessory right of pledge (Art. 3:236 BW) and the non-possessory right of pledge (Art. 3:237 BW). The first way to create a right of pledge is to transfer possession of the goods to the secured creditor or to a third person which is mutually agreed on. This is the only way to create a possessory right of pledge and it is also the oldest way. The second way to create a non-possessory right of pledge is to have a pledge contract in an authenticated form made and registered by a notary. The third and last way to create a non-possessory right of pledge in a private form, is to register the pledge contract by the tax authority. The registration by the notary or the tax authority serves the only purpose to prevent backdating of the documents and has not the purpose to be listed in an open public register. The tax authorities do not even have a register of security rights or copies of the right of pledge. The act the tax authorities have to do is to put a stamp or sticker with signature on the document to prevent backdating. Further the tax authorities register the names of the parties and the type of document. It is not obliged that the deed of right of pledge contains a statement of many words of the right of pledge giver that the assets will be encumbered with the right of pledge.⁴¹ Also the deed of the right of pledge has not to mention the legal ground of the transfer or a reference to the legal ground. Further, it is not required that the original deed of right of pledge is registered, but it is also possible and valid to register a fax copy of the original deed.⁴² This way of registration is convenient and practical and from the time point of view very handy. In the case of a conflict whether or not the copy is a true copy of the original, there will be a comparison. If there is any deviation this can lead to partial or whole invalid right of pledge. This is the way a right of pledge can be established in the Netherlands, but it differs in every member

⁴⁰ Idem.

⁴¹ Kortmann, S.C.J.J., 'Meijs q.q./Bank of Tokio – Mitsubishi', *Ars Aequi*, Number 10, 2002.

⁴² Idem.

state. “Although economically of overwhelming importance in our time, the legal regulation of non-possessory security is neglected in many countries, varies considerably from country to country, even within the European Union.”⁴³

3.3 Register of the rights of pledge

The proposal for the introduction of a register for rights of pledge is presented several times. The latest proposal is by Struycken in 2009 in a pre-advice for the Koninklijke Notariële Bond (KNB) where he proposed a register like the system in the US, which will be discussed later.⁴⁴ The first time a proposal was made, was by Mr Meijerers but it is later also done by Vriesendorp and Barendrecht.⁴⁵ Vriesendorp and Barendrecht concluded on reasoning of reasonableness and fairness (Art. 3:12 BW) that it would be desirable to introduce a register for rights of pledge. In their proposal only companies which are listed in the Chamber of Commerce (KvK) should file the rights of pledge and this should be done in a public register by the Chamber of Commerce. The filing should be done by a registration form similar as the financing statement in the US and it should also be possible with online connections. The time of arrival of the request is decisive for the ranking of the rights of pledge. Filing should be possible for the right of pledge giver and the right of pledge holder. Vriesendorp and Barendrecht also proposed that filing doesn't prevent the protection of a good faith acquirer. This means that a third party acquirer acts not only in good faith if the party has checked the register. This is a little bit strange in my opinion. If a party wants to buy a whole inventory or for example the whole stock of shoes, cars or machinery from a normal shop or dealer, this is no ordinary business. It may happen that a shop or dealer wants to close and sells his whole inventory or stock, but in that case it is not much effort to check in the register whether or not some of the assets of the company are encumbered. This principle does not mean that a buyer in ordinary course has the duty to check the register. The proposal of Vriesendorp and Barendrecht on the description of the right of pledge is that only a general description

⁴³ Hartkamp, H., Hesselink, M. Hondius, E. Joustra, C. Du Perron, C. Veldman, M. (eds.) *Towards a European Civil Code* (5th ed.), 2004.

⁴⁴ Struycken, T.H.D., 'Zekerheidsrechten en registratie' in Clumpkens, R.W. et al. (eds.), *Zekerhedenrecht in ontwikkeling*, 2009.

⁴⁵ Vriesendorp, R.D., Barendrecht J.M., *Zekerheid door wetenschap: Stil pandrecht en de toepassing van 3:12 BW*, 2005.

is required.⁴⁶ Such as stock, raw material, finished products, rolling equipment, claims and in the case of object financing a specific description of the encumbered object/asset. The right of pledge on future assets should not have to be filed again when the assets are received. The right of pledge on future claims should only be valid after the receipt of the list of new claims by the right of pledge holder. Further the filed statement should contain the name and contact information of the right of pledge holder. In this way third parties could find information to start a further investigation of the rights of pledge without being dependent of the right of pledge giver. Of course the register should be national and not local.

3.4 Security rights

Security rights is the umbrella term of mortgage, right of pledge, right of retention and other rights. Security rights are not registered in a public register in which one delivering party can see what rights of pledge a person of party has given to other parties. In the Netherlands companies are obliged to disclose in the annual report the rights of pledge they have established as security for certain debts.⁴⁷ Starting an insolvency proceeding will in principle not affect the rights of secured creditors under Dutch law. A right of pledge can be exercised 'as if there were no bankruptcy'.⁴⁸ There are some general tendencies in the Netherlands but also in Europe with respect to the developments of security rights. The enlarging of the range of security rights, which means that more forms of security rights are recognised. For example leasing is a form which is now more common and also recognised as a valid instrument.⁴⁹

3.5 Publicity

To construct an effective system of security rights, a pledge has to be effective against third parties. This means that secured creditors enjoy a preferential position over unsecured creditors but also that encumbered assets can not easily sold to a third party without paying to the creditor.

⁴⁶ Idem.

⁴⁷ Art 2:375 para 3 BW.

⁴⁸ Art. 57 para 1 Faillissementswet

⁴⁹ Kieninger, E. (Eds.), *Security Rights in Movable Property in European Private Law*, 2004.

There exists a silent right of pledge in the Netherlands on claims against debtors (Art. 3:239 BW). This is called an undisclosed right of pledge. In case of a silent right of pledge the debtor of the encumbered claim has not been notified of the right of pledge. The advantage of a silent right of pledge on claims is that the debtors of the right of pledge giver have no knowledge that the right of pledge giver needed a credit.

The registration of the deed of right of pledge by the tax authority serves only to prevent backdating by parties. There is no public register by the tax authorities which everybody can search through and has access to. In fact nobody can look or search into a register to see if some assets are encumbered with non-possessory rights of pledge. In France there is more attention for the publicity of rights of pledge. "The French legislator encourages the secured creditor to reinforce publicity of a non-possessory security in equipment by affixing a small plaque with details of the registration on an essential part of charged equipment."⁵⁰

There are two ways to discover if some goods are encumbered or not. The first way is to ask the owner of the assets, whether or not the goods are encumbered with a non-possessory right of pledge. The second way is to check the annual report of the company. Regarding Art. 2:375 para 3 BW the company is obliged to discover which goods are encumbered with a security right in the annual report. Unfortunately not every party is in the position to ask and to order the contracting party to let him see the annual report. Besides, the annual report represents the situation as on 31st December of last year. As most annual reports are published in the second quarter of the next year, the situation and which assets are encumbered in the annual report does not reflect the current situation. There is also a chance that the company has not revealed to the accountant or book keeper all the security rights which the company has given to financial institutions, finance companies, other companies or private persons. It is difficult to sue the owner of the company for this kind of fraud and get enough compensation when the company is in state of insolvency.

⁵⁰ Drobniq, U. 'Security Rights in Movables', in Hartkamp, H. et al. (eds.), *Towards a European Civil Code* (5th ed.), 2004, p. 747.

3.6 More than one right of pledge on the same asset

Because it is possible to establish a non-possessory right of pledge it is possible that more than one non-possessory right of pledge is established on the same asset.

Even in the case of a possessory right of pledge it is possible to establish more than one right of pledge on the same asset. This is possible because a right of pledge can be established when the secured creditor and debtor bring the encumbered asset in the power of a mutually agreed third party. The party who give the right of pledge can agree with two different creditors to establish the possessory right of pledge on the same asset (without knowing of each other) and to bring the encumbered asset in the power of the third party on the same time. The two different parties don't necessarily know the existence of each other established right of pledge. By establishing a non-possessory right of pledge it is easier to establish more than one right of pledge on the same good. The party that later established a right of pledge does not have to know of the first right of pledge that is established on the same asset. As written earlier the only way to discover whether or not there are some earlier rights of pledge established on the same asset is to ask the right of pledge giver, or to look in the annual reports. It turns out you have to rely on information of the right of pledge giver.

When the right of pledge giver went to insolvency or default the secured creditor can enforce his rights. The realisation of encumbered assets will lead to some proceeds. The proceeds will be divided amongst the parties with a right of pledge in the sequence in which the rights of pledge were established.

It may be possible that a secured creditor who thought he had a first right of pledge turns out to have a third right of pledge and ends up with nothing. Of course the party who gave the right of pledge on the assets or claims turns out not to be trustworthy and maybe fraudulent in his words and statements, but in insolvency cases this happens quite often. The party who gave the security is bankrupt and broke, so there is not much room for compensation.

3.7 Change in ranking; race for priority

In theory and practice it is possible that there are more rights of pledge on the same assets on the same time. The rights of pledge have a certain ranking to each other. The ranking can be unknown by the secured creditors. If the debtor is in default to his creditors, one of the secured creditors can decide to enforce his rights, in other words take recourse in respect of the encumbered assets and dispossesses the debtor of his assets. With that step the non-possessory right of pledge is transformed in a possessory right of pledge.

The following can happen. The owner of the asset has given the asset in a possessory right of pledge after the owner had given the asset in a non-possessory right of pledge to another secured creditor. The question arises whether or not there is a change in the ranking of the rights of pledge? The opinions are all different.⁵¹

As stated in Art. 3:238 para 2 the secured creditor to which has taken the assets in a possessory right of pledge, the secured creditor when he acts in good faith can plead on this Article. The basis is that when the non-possessory right of pledge is turned into a possessory right of pledge and the right of pledge holder was not aware of other security rights, the possessory right of pledge is the highest in ranking.

It may be that the secured creditor isn't aware of other security rights and brings the assets in his power in good faith. It may also be that the secured creditor acts not in good faith but in his own interest and has knowledge of the other non-possessory rights of pledge but declares that he didn't know of any other right of pledge because of his own interest and because he is self-seeking. The question is whether or not the secured creditor who transforms a non-possessory right of pledge in a possessory right of pledge and brings the goods in his power ought to know that there were other non-possessory rights of pledge.

First, the enforcing creditor should check the annual reports in my opinion. Second, in accordance to Art. 3:237 para 2 the deed of pledge of the non-possessory pledge

⁵¹ Mierlo van, A.I.M., 'Zekerheidsrechten', in Van Mierlo & Van Velten (Eds.). *Asser/Mijnssen*, 2010. and Stein, P.A. (Eds), '10.10 Eerst bezitloos pandrecht, daarna vuistpandrecht op dezelfde zaak gevestigd bij: Burgerlijk Wetboek 3, Artikel 238', *Groene Serie Vermogensrecht*, 2009.

has to contain a declaration of the pledge giver that he is authorized to establish a right of pledge on the assets and that the assets are not encumbered with other rights of pledge and if there are any other rights of pledge, which other rights of pledge are established on the assets. In practice most deeds of right of pledge don't contain any of such sentences or declarations. This is generally accepted and common practice. However, at the moment the secured creditor transforms his non-possessory right of pledge in a possessory right of pledge to act on good faith the secured creditor had to do some things in the past in my opinion.

At the time of the establishing of the non-possessory right of pledge the secured creditor ought to insert a declaration in the deed of right of pledge on the ranking or other security rights. When a secured credit did not inserted a declaration ,or did not asked for a written statement on the ranking at the time of establishing the right of pledge, in my opinion it is difficult to plead on good faith.

3.8 Description of the encumbered assets or claims, how specific?; identifiability

In the deed of right of pledge the encumbered assets or claims are described. This is necessary because in case of an insolvency the trustee has to determine which assets or claims are encumbered by the right of pledge so the assets don't belong to the property of other creditors. Some rights of pledge are described in detail and easy recognisable, where others are more vague, so that distinction of other assets is more difficult. Specificifiability or particularity is the key concept for the description of a right of pledge. Can a right of pledge be all-embracing and also embrace future assets or claims? There has to be made a distinction between assets and claims. First claims will be discussed and second the assets.

The following development is perceptible for the right of pledge on claims. For the transfer of an asset there has to be a delivery by virtue of a legal ground (Art. 3:84 para 1). By the legal ground the asset has to be described with enough determination. By the transfer of assets there is not much certainty in Dutch law to what extent the assets by transfer have to be individualised.

“Traditional it was probably the doctrine that every asset has to be fully determined by and at the time of the act of transfer.”⁵² It was impossible to have at one’s disposal future assets.

Two steps have led to a broader definition of claims.⁵³ The first step was the broadening of the definition “existing claims” to claims that have their foundation in a current existing legal relationship. The second step was recognising of the possibility of encumbering future claims. Hereby there is a development of the definition “claim” which embraces only current claims to a definition which embraces also future claims. Now claims could also contain future claims. Identification of the claims could alternatively be afterwards. Before the introduction of the silent right of pledge there existed a fiduciary assignment of claims. For the fiduciary assignment parties made use of assignment lists. Fiduciary assignment is since the introduction of the non-possessory right of pledge forbidden. The practice of making use of lists of claims however is also used for the new non-possessory and silent rights of pledge on claims. The Association of Banks in the Netherlands (NVB) developed a procedure in cooperation with the Treasury. In the deed of right of pledge there has to be a reference to a computer list where all claims are separately listed. The deed of right of pledge for claims only has to contain the name of the debtor, the number of the invoice of the first and the last claim of the list and the number of pages of the list. The Supreme Court in the Netherlands decided in the case *Stichting Spaarbank Rivierenland/Gispén q.q.* that it is sufficient that the deed of transfer contains information which makes it possible that eventually afterwards with this information the claims can be identified. At the moment of registration of the deed of right of pledge the total amount of the encumbered claims has to be known by the right of pledge giver and has to be mentioned in the deed of right of pledge. This can not be concluded with too much certainty because the mentioning of the amount is prescribed in the NVB procedure but it is denied in a case of the Supreme Court in

⁵² Struycken, T.H.D. 'De betekenis van het Anglo-Amerikaans zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code; over bepaaldheid en publiciteit', *Ars Aequi*, number 5, 1998 pp. 4.

⁵³ Struycken, T.H.D. 'De betekenis van het Anglo-Amerikaans zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code; over bepaaldheid en publiciteit', *Ars Aequi*, number 5, 1998.

the Netherlands where the Advocate-General states that when the amount is not sure it does not mean that the identifiability rule is not fulfilled.⁵⁴

For the description of assets, there are some other developments, which also has been discussed earlier by case law. In practice most creditors make use of stock and inventory lists. This is more or less the same system as the lists by the silent right of pledge on claims. This is recognised by Courts as discussed in the case law. By making use of these lists the assets can be identified and individualised. The conclusion is that also by the non-possessory right of pledge the asset has to be identifiable and individualised and an all-embracing generic right of pledge right can not come into existence without the right of pledge lists or inventory lists.

The ratio behind the embankment against an all-embracing universal right of pledge might be that the security giver is better protected against too far reaching rights of pledge without less consideration.⁵⁵ Future assets have to be registered again on the right of pledge lists or inventory lists and a right of pledge giver has more time for consideration because the right of pledge giver has to do new acts.

3.9 Enforcement of the right of pledge

Only the right of pledge giver is authorized to collect encumbered claims of the right of pledge on claims in case of a silent right of pledge and when there is no insolvency.⁵⁶ After notification to the debtors of the encumbered claims by the right of pledge holder, only the right of pledge holder is authorized to collect the claims. (Art. 3:246 para 1 BW) Because of the recognising of silent rights of pledge and the Articles 57 and 58 Faillissementswet where the holders of a right of pledge are defined as separatist, there arise specific problems. In case of insolvency and when the right of pledge holder has not given notification, the trustee is authorized to receive payments of the encumbered claims.

The right of pledge holder loses his position as separatist. The holder of the right of pledge has no substitution right of pledge on the proceeds. The holder of the right of pledge keeps his priority on the proceeds, but has to wait until the trustee has ended

⁵⁴ HR 16 juni 1995, NJ 1996, 508 (*Ontvanger Belastingdienst/ Rabobank IJmuiden*).

⁵⁵ Struycken, T.H.D. 'De betekenis van het Anglo-Amerikaans zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code; over bepaaldheid en publiciteit', *Ars Aequi*, number 5, 1998.

⁵⁶ Verdaas, A.J., 'HR 22 juni 2007 (ING/Verdonk q.q.): meer duidelijkheid voor de financieringspraktijk', *Nederlands Tijdschrift voor Burgerlijk Recht*, 58, 2007.

the procedure and contributes to the general insolvency costs.⁵⁷ In the case Mulder q.q./CLBN the Supreme Court in the Netherlands decided that the holder of the right of pledge is justified to enforce his rights on the claims as if there were no insolvency. So the holder of the right of pledge on claims can give notification to the debtors of the claim during the insolvency and hereby authorizes himself to collect the claims. Unfortunately, there is a tendency that during proceedings trustees chooses for a moratorium.⁵⁸ In the case of a moratorium the secured creditors are unable to enforce their rights. The trustee has therefore the chance to explore the possibilities for reconstruction or to find an efficient way to liquidate the company while the business can go on. For the secured creditor this is a threat because it is limiting the rights of secured creditors in insolvency.

4. Economic theory applied to the legal analysis

So far the economic theory and the legal analysis are discussed. The combination of the economic theory and the legal analysis lead to the preliminary conclusion that a register for the rights of pledge should be introduced. From the position of all three theories, namely transaction costs, false wealth doctrine and the market for lemons a register for rights of pledge would lead to a more optimal situation. Costs will decrease and more credits are likely to be granted. Further parties will trust each other more which will lead to more confidence in the economy. The legal analysis revealed some problems of the current situation. The current situation is a non-transparent situation of the right of pledge and a situation whereby the requirement of specification gradually is relaxed. The non-transparency of the situation causes problems whereas the specification requirements are solved with practical solutions. The introduction of a public register of rights of pledge will lead to a more optimal situation because the transaction costs of establishing a right of pledge will decrease. Further, an impression of false wealth can not be created any longer. Neither will parties be suspected of false poverty. Finally, also the good contracting parties who are willing to establish a right of pledge will stay on the market. All parties will gain from this new situation. The new situation will not hinder the establishing of more than one right of pledge on the same assets, but will lead to more transparency. Now the second holder of a right of pledge knows the value of his second right of pledge.

⁵⁷ Idem.

⁵⁸ Kieninger, E. (eds.), *Security Rights in Movable Property in European Private Law*, 2004.

5. Privacy and access to a Register of rights of pledge

The introduction of a public register for rights of pledge can appeal on resistance by strong protectors of privacy. For example the banking industry is keen on his secrecy. Because it is impossible to conceal that assets are encumbered it is not possible to draw incorrect conclusions from fragmentary information.⁵⁹ This is especially true for the German situation, but also applicable to the situation in the Netherlands although it is possible to get some information out the annual reports. It is therefore not possible to see how the company is funded and what the purpose of the credit is. For example, credit for investments or takeovers, is also kept secret. Companies are by confidentiality protected for all too prying competitors. Lwowski argues for example that the client base could be then public information.⁶⁰ If a competitor knows the client base, the competitor could break in, in the market of the company who files his right of pledge on claims. Further, it could be possible that competitors can search through the register to see whether or not credit is lately granted and that there maybe upcoming investments. The argument is not so convincing because if the system of notice filing is introduced, like the system in the US which will be discussed later, the only information which can be found in the registers is which assets or claims are encumbered. Because of the generic description which is possible, the clients of the claims of the right of pledge will not be disclosed, but only the fact that the claims to clients are encumbered. Another argument could be that owners of small companies don't find it comfortable that third parties could see that the company is financed by other parties and not by themselves. In some conservative branches this could be seen as a lack of stability or confidence in own qualities.

Despite of this reasoning in my opinion the access to the Register for rights of pledge should be open to everyone.

⁵⁹ Lwowski, H., "“Quiet” Creation of Security Interests or Filling', in Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

⁶⁰ Idem.

6. Comparative legal analysis

6.1 The US, UCC chapter 9; filing

In the US the security rights have to be registered in a public register. This is called filing. It is a simple form of the requirement of giving notice to third parties of security interest in assets or claims. Article 9 of the Uniform Commercial Code (hereafter UCC) is the law which administers this process. The UCC is a model law prepared by the National Conference of Commissioners on Uniform State Law.⁶¹ The separate States have to introduce the UCC in their own legislation and can adjust changes. Despite of this fact the UCC has uniformed the law.

In the United States in the nineteenth century people first began to use non-possessory security devices on personal property. The courts' reaction on this development was one of suspicion and hostility.⁶² The courts called it secret liens-privately created security interests because it was hidden from the public view. The government also saw the development in the security rights and developed a number of statutes.⁶³ There were a variety of secured transactions and developments grew rapidly. It was difficult for the law to have the same speed of developments and therefore the law remained some steps behind on the practice of the secured debtors and creditors. Another reason for introducing UCC chapter 9 was that every security device required other requirements and restrictions and the requirements and restrictions differed also in every different State. In 1962 the UCC Art. 9 was introduced. It was a new idea to unify all laws regarding this topic in all States. The approach of Art. 9 UCC is functional and not based on theoretical differences between instruments.⁶⁴ UCC Art. 9 applied to all secured transactions "that creates a security interest in personal property or fixtures by contract" and it applied "regardless of its form".⁶⁵ The term which is used in Art. 9 UCC for security rights is security interests. Under Art. 9 UCC there is for example no distinction between retaining title by a seller of assets and a creditor who facilitates a credit to a buyer to

⁶¹ Struycken, T.H.D. 'De betekenis van het Anglo-Amerikaans zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code; over bepaaldheid en publiciteit', *Ars Aequi*, number 5, 1998.

⁶² Livingston, M. 'A Rose by Any Other Name Would Smell as Sweet (or would it?): Filing and Searching in Article 9's Public Records', *Brigham Young University Law Review*, 2007.

⁶³ *Idem*.

⁶⁴ Sigman, H.C., 'Security in Movables in the US – UCC Art. 9', in Kieninger, E. (eds.), *Security Rights in Movable Property in European Private Law*, 2004.

⁶⁵ U.C.C. § 9 . 109 (1) (a) (1962) before U.C.C. §9 . 102 (1) (a)

purchase the assets from the seller and which uses a different form of securing the credit, because it performs the identical economic function. Under Art. 9 UCC it is allowed to create new types of security rights which are not described in the law for example to respond to business needs. This is not possible in most States in Europe which have a *numerus clausus* system, which means that only the forms of security rights which are described in the Civil Code are valid. With the introduction of Art. 9 UCC also publicity became more important.

Like possession the system of Art. 9 UCC provides publicity, it is not an end in itself but a tool for attributing third party effectiveness. Publicity in this way takes care of an inexpensive and efficient method of reducing risk.⁶⁶ The location of the assets and ownership of the assets is not relevant.

The primary purpose of the filing system is to provide a perfection mechanism which is inexpensive, easy to use and speedy.⁶⁷ Further the system has to be compatible with efficient commercial practices.

6.2 Attachment and perfection

Creating a security right in the US is done in two steps which can be done independent of each other and random. One step is called attachment and the other step is called perfection. Attachment takes place when there is a valid security agreement. The security agreement can exist of one sentence and can also cover the future proceeds of the assets.⁶⁸ To establish a valid security agreement, the security agreement has to be authenticated by the grantor, the value (credit) has to be transferred and the secured creditor has to have a right in the encumbered assets. The security agreement must be in written form but this could for example also be the minutes of a meeting. The security agreement may be in electronic form, but it must be authenticate which can be established through signing or a similar process which identifies the person and adopts or accepts the security agreement. The electronic record has to be retrievable in perceivable form. The security agreement is a security right which is valid between the parties, but is not in all cases valid against third parties. The security rights are only valid against third parties after

⁶⁶ Sigman, H.C., 'Perfection and Priority of Security Rights', in Horst, E.& Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

⁶⁷ *Idem*.

⁶⁸ Sigman, H.C., 'Security in Movables in the US – UCC Art. 9', in Kieninger, E. (eds.), *Security Rights in Movable Property in European Private Law*, 2004.

perfection. So after perfection other creditors or the trustee have to give the security rights priority so that the rights can be enforced to them. Perfection is the other step and is achieved by transfer of possession or filing.

This is done, when the security interest has been attached to the item of collateral.⁶⁹

A second way to achieve perfection in some instances is to take control. Filing is valid for a certain period, usually five years.

In practice, the first step is normally the attachment and the second step perfection. That is not surprising. For example that is the sequence in which mortgages are registered in the Netherlands.

However, in the US it is more common to have the steps the other way around.

Namely first perfection and later attachment.⁷⁰ So the potential debtor goes to a potential credit facilitator. The credit facilitator asks the potential debtor to sign a financing statement and files the financing statement. This step is the perfection.

Now the credit facilitator can start a search to other secured creditors of the potential debtor. If the outcome of the search is satisfied, the credit facilitator can supply the credit accompanied with a contract. This step is the attachment and hereby the security right is created and is enforceable against third parties. Art. 9 UCC does not require that information about the amount of the credit or the amount of the secured obligation is publicized in the financing statement.⁷¹

When there is a conflict over priority between the secured creditor and a buyer of one of the assets, the buyer wins. As stated in section 9-320 a buyer in ordinary course of business wins the conflict when the assets are farm products or products bought for the personal, family or household purposes, because it is in the interest of the secured creditor that ordinary business will not be disturbed. For the products bought for personal, family or household purposes to win the conflict it is required that the buyer bought the assets without knowledge of the security interest. For the buyer of farm products it is not even necessary that he didn't have knowledge of the security interest to win the conflict. Because usually the security right also encumbers the

⁶⁹ Sigman, H.C., 'Perfection and Priority of Security Rights', in Horst, E.& Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

⁷⁰ Struycken, T.H.D. 'De betekenis van het Anglo-Amerikaans zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code; over bepaaldheid en publiciteit', *Ars Aequi*, number 5, 1998.

⁷¹ Sigman, H.C., 'Perfection and Priority of Security Rights', in Horst, E.& Kieninger, E. (Eds.), *The Future of Secured Credit in Europe*, 2004.

proceeds of the sold asset, it is the risk of the debtor how he is dealing with the proceeds of the asset and not a risk of the buyer.⁷²

Conflicts over priority between creditors are won by the party who is the first to perfect which means the first party who files. There are some other special rights which have special rights to priority. For example the liens arising by operation of law for parties who are supplying services and materials with respect to the encumbered assets. This is somewhat similar to the “retentierecht” in the Netherlands and is in Art. 9 UCC arranged in section 9-333. This lien has in principle priority over any other security right.

6.3 Financing statement

The definition of the security rights is rather broad so it embraces all secured transactions and security rights. “The regime of UCC Article 9 has two interesting big properties: first the indefinite, unidentifiable, generic, all embracing character of the security law and second publicity.”⁷³ In the US secured debtors can give in one act or formality all their current and future assets, property and claims away as secured interest. It can be done in one contract, with one formality and one filing. The specification of the assets is not one by one but per category or genus. In the security agreement the encumbered assets can be described in a general way and not very specific because of the relaxed description rules.⁷⁴ “The object of the secured creditor is not identified but identifiable and in that way generic and all embracing.”⁷⁵ Filing a security interest is giving public notice of the security interest. The document that has to be filed is called the financing statement. The filing has to be done at the state or country level. The financing statement has to contain minimal pieces of information “such as the parties’ names, addresses, signatures, and a description or indication of the collateral.”⁷⁶ The filing gives only a notion of a security interest and a signal to other later creditors that the debtor has encumbered some

⁷² Idem.

⁷³ Struycken, T.H.D. ‘De betekenis van het Anglo-Amerikaans zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code; over bepaaldheid en publiciteit’, *Ars Aequi*, number 5, 1998, pp. 66.

⁷⁴ Sigman, H.C., ‘Perfection and Priority of Security Rights’, in Horst, E.& Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

⁷⁵ Struycken, T.H.D. ‘De betekenis van het Anglo-Amerikaans zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code; over bepaaldheid en publiciteit’, *Ars Aequi*, number 5, 1998, pp. 67.

⁷⁶ Livingston, M. ‘A Rose by Any Other Name Would Smell as Sweet (or would it?): Filing and Searching in Article 9’s Public Records’, *Brigham Young University Law Review*, 2007, pp. 111.

assets. The creditor can then start an inquiry or examination to the terms and details of the secured interest. The filing system is not set up to be the main source of data. It provides warning of the need of further investigation and makes it clear whether or not the grantor has made full disclosure.⁷⁷ Further it prevents back-dating like the system in the Netherlands.

When the debtor becomes insolvent and the security right is enforced both the creditor and the debtor will benefit from the highest possible net proceeds. Therefore, it is allowed under Art. 9 UCC to sell the encumbered assets by the secured creditor at a non-judicial sale. This way, it is more likely that the highest price is realized. When there is a public or private sale, which is like the normal procedure, the proceeds are likely to be higher than would be the case by sale of a court officer or trustee. Because of this mechanism, debtor cooperation is general common in the US situation. A solution of the insolvency of the debtor which is not known in the Netherlands, is the satisfaction of the secured creditor by acceptance of the encumbered assets as full or partial payment of the credit.⁷⁸ This is a practice which is not allowed by the law in the Netherlands, but it is even prohibited by Art. 3:235 BW.

The start of search in the records whether or not the debtor or party has given security rights to other parties starts with the name of the debtor. The filing system in the US has a couple of drawbacks and the search on the debtors' name is one of them. The debtors name can be misspelled or other errors could occur when the trade name is used instead of the official legal name of the legal body. The question arises which of the parties is responsible of the ability to finish a search with good results. Has the new creditor the duty to check all trade names and with possible different spellings, or has the debtor and old creditor the duty to file a correct financial statement with correct names and spelling? In other means which party is responsible? In the current situation of UCC Art. 9 the creditor and debtor who filed the secured interest has not all the responsibility. The registration system has minor

⁷⁷ Sigman, H.C., 'Security in Movables in the US – UCC Art. 9', in Kieninger, E. (eds.), *Security Rights in Movable Property in European Private Law*, 2004.

⁷⁸ UCC § 9 . 620 - § 9 . 622

errors in the name and the burden of the errors was under the first Art. 9 mostly born by the searchers.

“Filers were required to get fairly close to the debtor’s actual name on the financing statement, but searchers had the duty to execute a reasonably diligent search to retrieve the financing statement.”⁷⁹

In later versions of Art. 9 UCC it is required that the filers has to fill in the name of the secured debtor almost perfect on the financial statement to achieve perfection and not lose their security rights in a insolvency. Otherwise the financial statement would then be misleading.⁸⁰ One of the key elements of UCC Art. 9 is the functional approach of security rights. UCC Art. 9 is applicable to all legal constructions giving security for a payment, a claim or a performance. The constructions all have to be filed, for example the right of pledge, financial lease, retention of title and the hire-purchase.⁸¹ The system of filing is very efficient but not completely error-free as discussed by the name search, but it is not expensive to establish and financially self sustaining.

What could the governments and legislators in Europe learn from the situation in the US? The public open registration system in the US solves conflicts in two difficult situations. First, it hinders the good faith acquisition of all the encumbered assets at once when a party does not buy all the assets in the ordinary course of business. Second, it prevents the change in ranking of the security rights if a party takes the assets in a possessory right of pledge in good faith. In the Art. 9 UCC system it is not relevant whether or not a party had knowledge of the existence of the security interest. Third, the ranking of the security rights is always clear to all secured creditors and it is also clear whether or not there are any other secured creditors. In the US the fees to file a financing statement range from Dollar 5 to Dollar 20.⁸² Electronic filing is the most efficient technique and should therefore be encouraged. In general the authors in the US are very fond of the system.

⁷⁹ Livingston, M. ‘A Rose by Any Other Name Would Smell as Sweet (or would it?): Filing and Searching in Article 9’s Public Records’, *Brigham Young University Law Review*, 2007 pp. 164.

⁸⁰ UCC § 9 . 506

⁸¹ Struycken, T.H.D. ‘De betekenis van het Anglo-Amerikaans zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code; over bepaaldheid en publiciteit’, *Ars Aequi*, number 5, 1998, pp. 75.

⁸² Sigman, H.C., ‘Perfection and Priority of Security Rights’, in Horst, E.& Kieninger, E. (Eds.), *The Future of Secured Credit in Europe*, 2008.

6.4 Model law

In the European Union there are some developments and initiatives by several groups for a model law. The main initiatives are the Draft Common Frame of Reference (DCFR), the Principles of European Contract Law (PECL) and the UNCITRAL Legislative Guide on Secured Transactions (UNCITRAL).

The DCFR regulates the right of pledge on movable assets amongst other security rights in Book IX. The right of pledge on claims seems not to be regulated in Book IX as it is stated that “a security right can be created in a right to performance other than a right to the payment of money”⁸³. But the meaning of this Article is to describe the requirement of transferability of other rights to performances than the right to the payment of money. Later in Book IX the right of pledge on claims is regulated in Art. IX - 2:301. The proposed effectiveness against third persons differs to the current law in the Netherlands. In the DCFR the right of pledge has no effect against the following classes of third persons: holders of security rights in the encumbered asset, a creditor who has started to bring an execution against the assets and the insolvency administrator.⁸⁴ The reasoning behind these rules is vague in my opinion. It weakens the position of the holder of the right of pledge. Just for these situations the right of pledge proves its value. The fact that under the current law the right of pledge can be enforced as if there were no insolvency is attractive and one of the main characteristics of the right of pledge. The DCFR starts from the point that there is a European Register of proprietary security (rights of pledge including). A right of pledge has to be registered in this Register and will only be effective in that case. The entries in the register has to contain some minimal information: identified security provider (right of pledge giver), a minimum declaration as to the encumbered assets, one or several references to a list of categories of assets to which category the encumbered assets belong and a declaration of the creditor that the latter assumes liability for damages caused by a wrongful registration.⁸⁵ The information which should be supplied is more than in the financial statement in the US, namely the minimal declarations as to the encumbered assets. From the point of view of the right of pledge giver this is crucial information. The confidential nature of the granting

⁸³ Art. IX - 2:104 para 1 DCFR

⁸⁴ Art. IX – 3:101 DCFR

⁸⁵ IX – 3:308 DCFR

of the credit and the establishing of a right of pledge is disturbed. Entrepreneurs don't like to give insight in the amount of credit which has been supplied and therefore the amount of financing from third parties to their company. It may have to do with the Calvinistic history. Therefore it is recommendable to make the requirement of the amount/minimum declaration as to the encumbered assets not mandatory. The DCFR propose that anyone has access for searching purposes to the Register.⁸⁶

Let us now turn to the UNCITRAL Legislative Guide on Secured Transactions. The establishing of a right of pledge is regulated in part II and part IV. First, there is the notion that not in every State is there is a Register. Second, it is recognized that the establishment of a Register may constitute a significant change. For the identifiability of the assets UNCITRAL accepts that a generic description of the encumbered assets is sufficient.⁸⁷ So it is possible to establish an all-encompassing right of pledge. Further, the right of pledge automatically extends to the proceeds. The application of the UNCITRAL Guide is broad and all embracing because it also applies to other security rights like title based security devices (transfer of property). It embraces all devices which serves a security function. Under UNCITRAL the right of pledge could encumber all present and future assets or claims.⁸⁸ The UNCITRAL Guide makes a distinction between effectiveness between debtor and creditor and effectiveness as against third parties.⁸⁹ The right of pledge is effective between debtor and creditor after an agreement is concluded. The right of pledge is effective against third parties when the right of pledge is established with the law and methods referred to i.e. registration. Veneziano argues the UNCITRAL Guide recommends that a simple writing is sufficient to establish a right of pledge, hereby referring to general terms and conditions on an invoice.⁹⁰ In my opinion this is a too simple manner of establishing a right of pledge. A right of pledge document should be in written form with signatures of both parties. The signatures reflect offer and

⁸⁶ IX – 3:317 DCFR

⁸⁷ Veneziano, A., 'Attachment/Creation of a Security Interest', In Horst, E., Kieninger, E. (Eds.), *The Future of Secured Credit in Europe*, 2008.

⁸⁸ United Nations Commission on International Trade Law, *Security interests: Recommendations of the UNCITRAL draft Legislative Guide on Secured Transactions: Note by the Secretariat*, A/CN.9/631.

⁸⁹ *idem*, para 12-23 and para 30-48

⁹⁰ United Nations Commission on International Trade Law, *Security interests: Draft legislative guide on secured transactions: Note by the Secretariat: Addendum*, A/CN.9/631Add1, para 168. and Veneziano, A., 'Attachment/Creation of a Security Interest', In Horst, E., Kieninger, E. (Eds.), *The Future of Secured Credit in Europe*, 2008.

acceptance. Hereby there is a simple and objective system of checking whether or not consent of wills is reached. Reducing the requirements for the creation of a right of pledge to a minimum for the reason to enhance the granting of credit within the European market is maybe a goal to pursue, but if this mean's that a debtor's signature is too burdensome, this can be conflicting with the certainty of the law. The writing should indicate the grantor's approval of the record. However in some jurisdictions, like the German one, such agreements can be contained in standard terms.⁹¹ In my opinion this can be arguable for other security rights, like the retention of title, but not for the right of pledge.

Before the last model law is discussed, the PECL, I will discuss another option. Flessner proposes a European Security Right (ESR) as an extra instrument besides the existing security rights in the member states.⁹² It could be an optional security right above the member states domestic law. This seems an option for the long term and besides that the European Security Right does not solve the problem of transparency and the possible ranking.

The last model law I will discuss is the PECL. The right of pledge and other security rights are regulated in chapter 11. Two aspects will be highlighted. First, the scope of application and second the third party effects. The application of chapter 11 PECL does not hold for security rights under the law otherwise applicable when such security rights "must be by entry in a register maintained by or for the issuer."⁹³ This implies that mortgages in Holland are not governed by this model law. Right of pledge and more general security rights fall under the following description in the PECL: "assignment by agreement of a right to performance ("claim") under an existing or future contract."⁹⁴ The PECL "also applies to the assignment by agreement of other transferable claims."⁹⁵ Further, ""assignment" includes an assignment by way of security."⁹⁶ The description of the instrument security right is a bit laborious in the PECL and it is a broad, all embracing definition. One of the

⁹¹ Veneziano, A., 'Attachment/Creation of a Security Interest', In Horst, E., Kieninger, E. (Eds.), *The Future of Secured Credit in Europe*, 2008.

⁹² Flessner, A., 'Security Interests in Receivables – A European Perspective', in Horst, E., Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

⁹³ Art. 11:101 para 3a PECL

⁹⁴ Art. 11:101 para 1 PECL

⁹⁵ Art. 11:101 para 2 PECL

⁹⁶ Art 11:101 para 4 PECL

characteristics of the property law in Holland is the *numerus clausus*. This means that in the Law in the Netherlands only recognises a select number of security rights which are listed in the law. Other security rights are not valid or will be treated as one of the selected recognised security rights. The PECL takes a whole other approach and embraces many forms of security rights, for example forms of lease.

The PECL has the following rule on third party effects.⁹⁷ Priority is determined by the time of notification to the debtor. The right of pledge has not to be registered but the time of notification to the debtor is decisive for the priority. The party that first notified the debtor has priority over any earlier party. There is an exception to this when a later creditor at the time of establishing the right of pledge knew or should have known of the earlier establishing of a security right. In that circumstance the earlier holder of the security right has priority. Also under the model law of the PECL it is hard to find out whether or not this was the case, because there is no requirement for publicity. It is even not required to have a document in writing to establish a right of pledge.⁹⁸ In my opinion such lack of requirements makes the security rights vulnerable for fraudulent behaviour and acts of *Paulia* would be much easier. Concluding, also under the model law of the PECL the problem of transparency will exist and the determination who has the first right of pledge will persist.

7. Effective Enforcement of Judgments in the European Union: the Transparency of Debtors' Assets

The problem of the transparency of assets also has the attention of the European Commission which resulted in a green paper and a former study.⁹⁹ The inducement of this study was the structural differences between the national procedures in enforcement proceedings. Enforcement proceedings are regulated in procedural law. In the European Union there is a free movement of judgements. This means that a judgement in one member state is valid in another member state.

Nevertheless enforcement and execution of the judgement remains subject to the procedural and legislative autonomy of the Member State where the judgement is carried out. The principle of non discrimination (Art. 12 EC Treaty) on the other hand

⁹⁷ Art 11:401 PECL

⁹⁸ Art 11:104 PECL

⁹⁹ Hess, B., *On making more efficient the enforcement of judicial decisions within the European Union: Transparency of a Debtors' Assets, Attachment of Bank Accounts, Provisional Enforcement and Protective Measures*. Study No. JAI/A3/2002/02 General Report. Heidelberg: University of Heidelberg, 2004.

also applies to the national enforcement proceedings. So a security right or an enforceable instrument must be treated equally between all competing domestic creditors with the same rights. In practice however, there are differences in the efficiency how Member States enforce the judgments. Therefore the ability to recover debts for creditors is not in all Member States equal which leads to inefficiencies in the European Judicial Area. Also provisional and protective measures are not always equal between the Member States.¹⁰⁰

This all hinders the free single market in the European Union especially in cross border transactions and the free movement of judgement in the European Union. In the worst case scenario creditors don't enforce their claims in other Member States but write them off.

7.1 Debtors' Declaration

In order to recover monetary judgements, creditors will seek for information about the assets and the bank accounts. The creditor will look for all remedies and provisional remedies such as allowing an immediate attachment of bank accounts. It is also important to look at some different solutions to the problem of information gathering. In some Member States there exists a debtor's declaration. The form of this instrument differs between the Member States and the stage of process in which this instrument is used also differs in the Member States. The forms can be distinguished in two main forms: First, a declaration where it is obliged that all assets to be disclosed and second, a form where it is obliged to disclose only the assets sufficient to recover the claim of the creditor.¹⁰¹

The stage in the process where the debtor's declaration is asked and obliged differs also from Member State to Member State. In some Member States the declaration is only taken if the first attempts of seizure are unsuccessful or likely to be unsuccessful. In other Member States the debtor's declaration is taken at the beginning of the proceedings to enable the enforcement organs to have all possible information at an early stage. In both systems the debtor's declaration is requested by the creditor.

¹⁰⁰ Idem.

¹⁰¹ Idem.

Another difference is how the information about the assets is obtained. In some Member States taking the declaration is done in the form of a hearing before the enforcement court with documentary evidence. In other Member States taking the declaration is done by filling out mandatory forms. The debtor's declaration relies on the willingness to cooperate of the debtor. If he refuses to cooperate, the only instrument the enforcement organs have is a penalty, imprisonment and in some Member States there is a public register where it is listed which persons gave a declaration and which persons didn't.¹⁰²

The Netherlands has no debtor's declaration but has some other ways to get information about the debtor. In the Netherlands bailiffs can obtain information in the social security registers about the address and employment of the debtor.

Hess concluded with the opinion that there is a need for Community action.¹⁰³ The study recommended four instruments: a European assets declaration of the debtor, a European Garnishment order, a European Garnishee's Declaration and a European Protective order. The four recommended instruments are all instruments which are taken at the end of the process, when there is insolvency and when a contract is closed. These instruments are no solutions for better transparency of debtors' assets before a contract is closed.¹⁰⁴

8 The right of pledge in practice

How big is the role of security rights in contemporary economics? I will now discuss a few examples. Of course security rights are important for ordinary business and the financing of small and medium enterprises. Further the possessory right of pledge is used by houses of right of pledge. These houses grant credits to private persons by taking for example a TV in a possessory right of pledge. There are also other examples.

In the year 2009 ABN AMRO and JP Morgan had a conflict over the right of pledges on a couple of famous Dutch paintings.¹⁰⁵ Both ABN AMRO and JP Morgan were the

¹⁰² Idem.

¹⁰³ Idem.

¹⁰⁴ Idem.

¹⁰⁵ Jensma, F. 'Juridische strijd over schilderij 'Gouden Bocht'; Miljonair gaf doek in onderpand', *NRC Handelsblad*, 2009, 24 April, p. 9., and Redaction, 'ABN en JP Morgan in 'race om Rembrandts'', *De Telegraaf*, 2009, 25 april, p. 27.

creditors of Louis Reytenbagh a private person who is a big trader/investor in stocks. ABN AMRO Bank and JP Morgan weren't aware of each other's security rights. In the mean time the famous paintings were sold to the Rijksmuseum. The credits which were granted were subsequently 52 million euro's for ABN AMRO Bank and 33 million euro's for JP Morgan and those were claimed. Reytenbagh sold the paintings to the Rijksmuseum without telling about the security rights.¹⁰⁶ The case of the paintings as encumbered assets is a good example of the uncertainty for the creditors of the ranking of the right of pledges and the non-transparency of the right of pledges in the current system.

The second example is about the possible use of a non-possessory right of pledge. Is it possible to use a right of pledge on the 'slots' of airports used by airline companies?¹⁰⁷ Airline companies pay large amounts to acquire certain rights on departure and arrival times at airports, the slots. Airlines that would like to have some extra financial room or that would like to have a credit to finance the purchase of the slots could use the slots to encumber. The encumbered assets are in that case slots. Airline companies are not the owner or entitled parties of the slots but they have the usufructuary rights on the slots. Further it is explicitly allowed to transfer or exchange the usufructuary rights.¹⁰⁸

¹⁰⁶ Idem

¹⁰⁷ Wegter, J. 'Slots luchthavens zijn verkoopbaar', *Het Financieele Dagblad*, 2009, 7 Januari, p.7.

¹⁰⁸ Idem.

9. Conclusion and where to go

Finally I would like to summarize on the question whether or not there is a need to introduce a Register of rights of pledge and whether or not this will lead to an increase in the transparency of debtors' assets?

The current situation leaves room for a more efficient system and there is a broad support for changes. There is a debate going on between several authors on where to go to reach a more transparent system. Parties in the market do not have an incentive to come with their own solution.

From the economic theoretical background the conclusion is that the introduction of a Register shall lead to a decrease in transaction costs. Further it will hinder the impression of false wealth and in some cases of false poverty. The introduction of a Register hinders the existing of a market for lemons and shall lead to a more transparent and efficient system of rights of pledge.

From the legal analysis the conclusion is that the current situation is one of a difficult enforcement of the right of pledge. A situation is imaginable where it is easy to have multiple rights of pledge on the same asset without the knowledge of all secured creditors. In some cases it could also be that the ranking suddenly changes because a creditor transforms the non-possessory right of pledge in a possessory right of pledge.¹⁰⁹ Further there is a trend of relaxing the requirements on how specific the description of the encumbered assets or claims should be in the deed of right of pledge. For the identification of the encumbered assets or claims parties are allowed to look in computer lists or in the book keeping. Combining the economic theory and the legal analysis clearly reveals the need for a public Register.

The privacy issue of the introduction of a Register is discussed and on this topic we can conclude that there is no need to fear that a client base will become public information. Also the fear in a Calvinistic tradition that the amount of credit will be open for the public access and will become public knowledge can be enfeebled because the amount of credit has not to appear in the financing statement.

¹⁰⁹ Art. 3:238 para 2 BW

The comparative legal analysis can be concluded with the observation that the filing system in the US which is governed by Art. 9 UCC functions very well. Access to the Register is open for everyone. Also other model laws suggest the existence of a Register.

My proposal would be to introduce a Register like Art. 9 UCC, with access open for every party in the Netherlands. The answer to the question which party should keep the Register is difficult. Several parties would be suitable. Notaries, BKR, KvK and maybe the Kadaster? The choice which party should keep the Register is a political question. In my opinion the BKR or notaries should keep the Register.

To conclude: there is a clear need to introduce a Register of rights of pledge and it will lead to an increase in the transparency of debtors' assets.

Further research suggestion

During the research I encountered that the non-possessory right of pledge or other security rights are used in the process of securitization by financial institutions. I enclosed a short introduction of the topic in annex B. It is a really complex transaction and process with lots of consequences. A further research suggestion from my side would be a research to the legal ground of the transfer and whether or not this is a violation of the prohibition of transfer for security?¹¹⁰

¹¹⁰ Art 3:84 para 3 BW

References

Books

Armour, J., 'The Law and Economics Debate About Secured Lending: Lessons For European Lawmaking?', in Horst, E., Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

Bruisten-Dijkhof, L.M., *Pandrecht in de notariële praktijk*, 2007.

Cooter, R., Ulen, Th, *Law & Economics* (4th eds.), 2004.

Drobnig, U. 'Security Rights in Movables', in Hartkamp, H. et al. (eds.), *Towards a European Civil Code* (5th ed.), 2004.

Flessner, A., 'Security Interests in Receivables – A European Perspective', in Horst, E., Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

Hartkamp, H., Hesselink, M., Hondius, E., Joustra, C., Du Perron, E., Veldman, M. (eds.), *Towards a European Civil Code* (5th ed.), 2004.

Heuvel van den, N.W.M. *Zekerheid en voorrang*, 2004.

Horst, E., Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

Kieninger, E. (eds.), *Security Rights in Movable Property in European Private Law*, 2004.

Lwowski, H., "'Quiet" Creation of Security Interests or Filling', in Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

Mierlo van, A.I.M., 'Zekerheidsrechten', in Van Mierlo & Van Velten (eds.). *Asser/Mijnssen*, 2010.

Pindyck, R.S. & Rubinfeld, D.L., *Microeconomics* (6th eds.), 2005 .

Sigman, H.C., 'Security in Movables in the US – UCC Art. 9', in Kieninger, E. (eds.), *Security Rights in Movable Property in European Private Law*, 2004.

Sigman, H.C., 'Perfection and Priority of Security Rights', in Horst, E. & Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

Stein, P.A. (eds), '10.10 Eerst bezitloos pandrecht, daarna vuistpandrecht op dezelfde zaak gevestigd bij: Burgerlijk Wetboek 3, Artikel 238', *Groene Serie Vermogensrecht*, 2009.

Struycken, T.H.D. 'Zekerheidsrechten en registratie', in Clumpkens, R.W. et al. (eds.), *Zekerhedenrecht in ontwikkeling*. Sdu Uitgevers.

Study Group on a European Civil Code & Research Group on EC Private Law (Acquis Group) *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR) Outline Edition*, 2009.

Veneziano, A., 'Attachment/Creation of a Security Interest', in Horst, E., Kieninger, E. (eds.), *The Future of Secured Credit in Europe*, 2008.

Vriesendorp, R.D., Barendrecht J.M., *Zekerheid door wetenschap: Stil pandrecht en de toepassing van 3:12 BW*, 2005.

Articles

Almeida, H., Campello, M. 'Financial Constraints, Asset Tangibility, and Corporate Investment', *NBER Working Paper Series*, 2006.

Cadwell, C., Meagher, P., 'Collateral Law and Economic Transitions'. *Economic Reform Today*, Number 1, 1996.

Jensma, F. 'Juridische strijd over schilderij 'Gouden Bocht'; Miljonair gaf doek in onderpand', *NRC Handelsblad*, 2009, 24 April, p. 9.

Kortmann, S.C.J.J., 'Meijs q.q./Bank of Tokio – Mitsubishi', *Ars Aequi*, Volume 51, Number 10, 2002.

Livingston, M. 'A Rose by Any Other Name Would Smell as Sweet (or would it?): Filing and Searching in Article 9's Public Records', *Brigham Young University Law Review*, Volume 2007, Number 1, 2007.

Redaction, 'ABN en JP Morgan in 'race om Rembrandts'', *De Telegraaf*, 2009, 25 April, p. 27.

Ruys, W., 'Securitisatie een juridisch complexe aantrekkelijke transactie', *Het Financieele Dagblad*, 1996, 12 June, p. 6.

Struycken, T.H.D. 'De betekenis van het Anglo-Amerikaanse zekerhedenrecht, in het bijzonder de floating charge en Article 9 Uniform Commercial Code: over bepaaldheid en publiciteit', *Ars Aequi*, Volume 47, Number 5, 1998.

Verdaas, A.J., 'HR 22 juni 2007 (ING/Verdonk q.q.): meer duidelijkheid voor de financieringspraktijk', *Nederlands Tijdschrift voor Burgerlijk Recht*, Volume 58, 2007.

Wegter, J. 'Slots luchthavens zijn verkoopbaar', *Het Financieele Dagblad*, 2009, 7 Januari, p.7.

Wibier, R.M. 'Covered Bond Programmes: De titel van overdracht, artikel 3:84 lid 3 BW en het causa-vereiste bij overeenkomsten', *Nederlands Juristenblad*, Number 3, 2008.

Zwalve, W.J. 'Over generale en bijzondere zekerheidsrechten', *Ars Aequi*, Volume 55, Number 1, 2006.

Cases

HR 14 oktober 1994, NJ 1995, 447 (*Stichting Spaarbank Rivierland/Gispen q.q.*).

HR 16 juni 1995, NJ 1996, 508 (*Ontvanger Belastingdienst/ Rabobank IJmuiden*).

HR 23 april 1999, NJ 2000, 158 (*Rabobank/Wollie*).

HR 20 september 2002, NJ 2002, 610 (*ING/Muller q.q.*).

Vzr. Rb. Utrecht 1 september 2004, LJV AQ9866 (*Rabobank/RCI Financial Services*).

Vzr. Rb. Leeuwarden 28 oktober 2009, LJV BK2026 (*Speksnijder/Z*).

Papers/ Other

Green Paper, *Effective Enforcement of Judgements in the European Union: the Transparency of Debtors' Assets*, COM(2008) 128, March 2008, Brussels.

Commission on European Contract Law, Lando, O. (Chairman). *The Principles of European Contract Law (PECL)*.

Hess, B., *On making more efficient the enforcement of judicial decisions within the European Union: Transparency of a Debtors' Assets, Attachment of Bank Accounts, Provisional Enforcement and Protective Measures*, Study No. JAI/A3/2002/02 General Report. Heidelberg: University of Heidelberg.

United Nations Commission on International Trade Law, *Security interests: Recommendations of the UNCITRAL draft Legislative Guide on Secured Transactions: Note by the Secretariat*, A/CN.9/631.

United Nations Commission on International Trade Law, *Security interests: Draft legislative guide on secured transactions: Note by the Secretariat: Addendum*, A/CN.9/631Add1.

Annex A:

Example of financing statement for Register of rights of pledge:

Name right of pledge giver: Volvo Hooftman Waddinxveen B.V.
Dorpstraat 38, 2904 PK Waddinxveen

Name right of pledge holder: Rabobank Gouda U.A.
Plein 1, 2801 SN Gouda

Type of security right: non-possessory right of pledge

Indication of the
encumbered assets
or claims: all current and future automobiles of
the brand Volvo owned by Volvo
Hooftman Waddinxveen B.V. and all
technical equipment owned by Volvo
Hooftman Waddinxveen B.V.

Date: November 9th 2010

Signatures:

Annex B:

Securitization

Security rights play also a role in the securitization of mortgages. The first time a financial transaction on large scale on securitization did take place in the Netherlands was on June 28th 1996.¹¹¹ Over the years the transactions concerning securitization increased till the recent recession. According to some economists and authors the large scale of securitization and the non-transparency of the transactions and the scale of securitization and also the non-transparency of the terms of securitization was one of the causes of the recent recession. Securitization could have been a cause of the recession because the bonds which had value derived of portfolios of mortgages turned out not to be the safe investment as foreseen as a consequence of the problems on the housing market of the US. The decrease of the value of the bonds caused the big depreciations on the portfolios of bonds by banks and other financial institutions like pension funds.¹¹²

One of the elements of securitization is the right of pledge on claims. In Common law the lawyers who creates such contracts make use of trusts. In the Netherlands however there exist not that instrument in law so the lawyers have to make use of a security right in the form of a right of pledge. The name for the type of instrument the lawyers use is asset backed security. The encumbered assets/claims are the portfolio of mortgages. The process is as follows: A company called the originator sells certain assets to another for the purpose established partnership/legal entity called special purpose vehicle (spv). The spv finances the purchase of claims with the issue of stocks or bonds. In a special case of securitization called covered bond programmes the bonds are issued by the originator, but the spv called the covered bond company is also a guarantee (borg) to the bond holders.¹¹³ The claims exist of mortgages. The stocks of the spv are usually hold in a foundation. The bonds issued by the spv are sold in the market. It is beneficial for the issuer of the bond to do this at the lowest possible interest rate. Therefore the issuer asks for a rating by a rating agency like Moody's or Standard & Poor's. The higher the rating the more likely a low

¹¹¹ Ruys, W., 'Securitisatie een juridisch complexe aantrekkelijke transactie', *Het Financieele Dagblad*, 1996, 12 June, p. 6.

¹¹² Wibier, R.M. 'Covered Bond Programmes: De titel van overdracht, artikel 3:84 lid 3 BW en het causaverreichte bij overeenkomsten.' *Nederlands Juristenblad*, Number 3, 2008.

¹¹³ Wibier, R.M. 'Covered Bond Programmes: De titel van overdracht, artikel 3:84 lid 3 BW en het causaverreichte bij overeenkomsten.' *Nederlands Juristenblad*, Number 3, 2008.

interest rate is, so the rating agencies can feel pressure to give a high rating. The issuer of the bonds benefits of a high rating and also pays for the rating to the rating agency. So the rating agency can have a conflict of interest because the agency assesses and gives the rating to the principal. The statutory objective of the spv is to acquire and hold the claims and to issue bonds for the specific securitization transaction. It is important to restrict the purpose and minimise the room to act of the spv to minimise the risks. The risk is also decreased because the claims are given as a right of pledge/ security right to a trustee for obeying the obligations out of issuing the bonds. All administrative tasks are remained with the originator. The transfer of the claims from the originator to the spv has to satisfy some requirements of the Dutch law. Notification to the debtors of the transfer is one of the requirements. To camouflage the transfer the notification can be done inconspicuous in small letters on the invoice. A second option is to choose a name for the spv which is more or less similar to the originator. A third option is to give notification to the debtors of the claims on a later point of time when certain circumstances arises. The circumstances point to the situation when the originator comes into trouble and is in default. Before notification is given the spv has to accept that debtors of the claims can pay with relief to the originator and that the spv is not the owner of the claims, because the transfer of ownership did not take place. The transfer is done by silent cession conform Art. 3:94 para 3 BW.¹¹⁴ To minimise the risk of not having a transfer of ownership certain clauses are attached.

It is interesting that by the securitization the instrument of the right of pledge is used. The parties also use a trustee. The trustee receives a right of pledge as security for the buyers of the bonds. Usually the right of pledge will be a right of pledge on claims. Further the trustee will be a guarantee (borg) for the spv. If the trustee has to pay, the trustee will enforce his right of pledge. This right of pledge is established for extra certainty/security for the buyers of the bonds. In normal situations the right of pledge will never be enforced until real problems occurs.

¹¹⁴ Wibier, R.M. 'Covered Bond Programmes: De titel van overdracht, artikel 3:84 lid 3 BW en het causaverste bij overeenkomsten.' *Nederlands Juristenblad*, Number 3, 2008.

By the transfer of the claims in principle all rights are also transferred, like the Nationale Hypotheek Garantie, but this should be carefully examined. Of course the Dutch Central Bank has the supervision on the process, but there are some evasions. First the spv should in principle have a license because it could be seen as an instance under the definition of credit agency/organization (kredietinstelling). The spv could avoid the licence by only issuing bonds to professional investors with a maturity shorter than two years. In that instance the spv could have an ad hoc exemption. Second the Nederlandsche Bank has supervision when a bank is involved because of the supervision of the solvability of the bank.¹¹⁵

It could be a question whether or not the securitization process is a violation of the prohibition of transfer for security. In covered bond programmes not the spv but the originator is the issuer of the bonds. The holders of the bonds can take recourse on the whole capital and equity of the originator. The spv is in that case called a cover bond company but remains the entity towards the claims are transferred, like in the normal securitization process.¹¹⁶ But what is the valid legal ground of the transfer? Wibier argues that the transfer has not a legal ground for security, because the covered bond company received the claims unconditional and consequently the originator transferred the assets unconditional. Wibier argues that the legal ground is the whole transaction and the connected elements and not a legal ground of recourse. In my opinion the answer to this question could be a topic for further research.

¹¹⁵ Ruys, W., 'Securitisatie een juridisch complexe aantrekkelijke transactie', *Het Financieele Dagblad*, 1996, 12 June, p. 6.

¹¹⁶ Wibier, R.M. 'Covered Bond Programmes: De titel van overdracht, artikel 3:84 lid 3 BW en het causaveren bij overeenkomsten.' *Nederlands Juristenblad*, Number 3, 2008.