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## ARTICLE 9 NORM ENTREPRENEURSHIP

Roderick A. Macdonald\*

### I. INTRODUCTION

For half a century there has been great interest in the reform of chattel security law almost around the world.<sup>1</sup> A global economy is said to demand a commercial law that facilitates free flows of capital, goods and services. Efficient secured transactions regimes are thought to be a key piece of the puzzle. Need it be added that Article 9 and its derivatives have been cast as the *nec plus ultra* of the endeavour?

This article addresses secured transactions reform with a particular focus. How have civil law countries actually gone about modernizing

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\* F.R. Scott Professor of Constitutional and Public Law, McGill University; Fellow, Pierre Elliott Trudeau Foundation. This is a revised version of a presentation to the Panel "Exportability of North American Chattel Security Regimes: Successes and Failures" at the 35th Annual Workshop on Commercial and Consumer Law, held at the Faculty of Law, University of Toronto, October 21-22, 2005. I should like to thank my colleagues Nicholas Kasirer, Lionel Smith, Stephen Smith and Catherine Walsh as well as the participants at the Workshop and Mr. Harry Sigman of the California Bar for their comments on earlier drafts. Errors and exaggerations are mine alone.

1. Two recent volumes provide a good conspectus of challenges and developments in the North Atlantic trading block. See Eva-Maria Kienninger, ed., *Security Rights in Movable Property in European Private Law* (Cambridge, Cambridge University Press, 2004), and the essays in Part I of the collection in particular; G. McCormack, *Secured Credit under English and American Law* (Cambridge, Cambridge University Press, 2004). Both also contain excellent bibliographies.

See also the following websites: UNCITRAL — *Draft Legislative Guide on Secured Transactions* (updated as of January 2006) <<http://www.uncitral.org/en/commission/workinggroups/6securityinterests.html>>; World Bank, *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* (April 2001), <[http://www.wds.worldbank.org/external/default/wdsContentServer/IE3P/IB/2004/11/16/000160016\\_20041116125658/RenderedPDF/3066470v.10DC200100008.pdf](http://www.wds.worldbank.org/external/default/wdsContentServer/IE3P/IB/2004/11/16/000160016_20041116125658/RenderedPDF/3066470v.10DC200100008.pdf)>; and <<http://www.worldbank.org/firm>>; European Bank for Reconstruction and Development, *Model Law on Secured Transactions, 1994* — <<http://www.ebrd.com/pubs/legal/5690.pdf>>; Asian Development Bank, *Law and Policy Reform at the Asian Development Bank, 2000* — <[http://www.adb.org/Documents/Others/Law\\_ADB/lpr\\_2000\\_2.asp?p=lawdevt](http://www.adb.org/Documents/Others/Law_ADB/lpr_2000_2.asp?p=lawdevt)>; Organization of American States, *Model Inter-American Law on Secured Transactions, 2002* — <[http://www.oas.org/dil/CIDIP-VI-secured-transactions\\_Eng\\_home.htm](http://www.oas.org/dil/CIDIP-VI-secured-transactions_Eng_home.htm)>.

their law of security on property?<sup>2</sup> What has been learned from the experience? What remains to be done?<sup>3</sup> And finally, although by indirection, how can Article 9 itself be recast so as to take advantage of insights acquired in civil law traditions?<sup>4</sup>

I base my observations and conclusions on personal experiences in two civil law jurisdictions: Quebec and Ukraine. Before I discuss these experiences, I want to state a pair of transplantation caveats about western European law as a *phylum*, about commercial law as a *genus*, and about secured transactions law as a species of social regulation.<sup>5</sup> First, and most importantly, we should never take for

2. The title of the panel at which this paper was presented — Exportability of North American Chattel Security Regimes: Successes and Failures — suggests that the North American norm export industry encompasses not only the Article 9/PPSA model, but also the model of secured transactions enacted in Book Six of the *Civil Code of Québec* (CCQ). Notwithstanding its narrower title, this paper covers both Article 9/PPSA and CCQ exports.
3. While the focus in this article is on, broadly speaking, civil law countries, most of the lessons about Article 9 norm entrepreneurship have a more general application — for example to states in the Islamic world, or to parts of the Asia-Pacific region that do not have private law regimes grounded in either European private law tradition. On some of the problems of cross-tradition law reform, see H.P. Glenn, *Legal Traditions of the World*, 2nd ed. (Oxford, Oxford University Press, 2004) especially at ch. 6, 9 and 10. Moreover, the special problems of addressing regimes of secured transactions appropriate for Canadian First Nations can be seen as further instantiations of the general lessons raised here. See notably two studies prepared for the Law Commission of Canada in 2005: R.C.C. Cuming, *Report on Security Interest and Money Judgements Enforcement Against Property of First Nations Persons: Background Issues and Suggested Approaches*; S. Ben-Ishai, *Enforcing Security Interests and Money Judgements on Reserves: Literature Review*.
4. In posing this last question I mean to raise general themes about the circulation of legal ideas, and in particular, problems of comparative law, transplants and social change. On the larger point, see the essays in H.P. Glenn, ed., *Droit québécois et droit français: communauté, autonomie, concordance* (Montreal, Yvon Blais, 1993) and in *La circulation du modèle juridique français: journées franco-italiennes de l'Association Henri Capitant pour les amis de la culture juridique française* (Paris, Litec, 1994). On the latter point see D. Nelken and J. Feest, eds., *Adapting Legal Cultures* (Oxford, Hart Publishing, 2001), and *infra*, Part I.4.
5. The biological metaphor is not new although the point of its deployment here is. See G. Samuel, “Can Gaius be Compared to Darwin?” (2000), 49 I.C.L.Q. 6, reviewing P. Birks, ed. *English Private Law* (Oxford, Oxford University Press, 2000) and G. Samuel, “Can the Common Law be Mapped” (2003), 55 U.T.L.J. 271, reviewing S. Waddams, *Dimensions of Private Law* (Cambridge, Cambridge University Press, 2003). See also S. Smith, “A Map of the Common Law” (2004), 40 C.B.L.J. 364, and N. Kasirer, “English Private Law, Outside In” (2004), 3 Oxford University Commonwealth Law Journal 249 for complementary reflections on the epistemology of legal classification. The reference to the *Linnaean* taxonomic system is intended as a reminder that the object of law reform is not just on first-order legal rules, and the

granted the economic, political, social and institutional factors that make it possible to even contemplate security on property regimes as a means for enhancing access to credit. Second, we should never underestimate the fragility of these legal regimes, especially as they relate to the necessary citizen confidence and willingness to accept judicially declared outcomes that underpin them.

There are several lessons to be learned from these attempts at modernizing the law of security on property. Methodologically, in conceiving the architecture of reform it is necessary to differentiate one's interest (the overall goals to be achieved — for example, an efficient and effective regime) from one's position (the specific legal techniques deployed to achieve these goals — for example, the Article 9 model). The best way to do this is to refocus on core principles. Moreover, legislation is not just an act of will. To be successful reform cannot just be a transplant operated by political *diktat*. Third, the effectiveness of even culturally sensitive law reform is not automatic. To ensure that the regime takes root, a state must take steps to acculturate legal actors both prior to enactment and for decades afterwards. Finally, in the realm of secured transactions law, the central issue for Article 9 proselytizers is not just formalism vs. functionalism: because all western European systems, from Article 9 through the most recondite civil law regime, mediate between form and function, the real question is “how far functionalism?”<sup>6</sup>

## II. “HAVE I GOT A LAW FOR YOU...”

As a ground for exploring these key lessons, I should like to recount in some detail two of my experiences with secured

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impact of classification on law reform extends to higher order conceptual structures through which these rules speak to everyday human interaction. See Roderick A. Macdonald, “Triangulating Social Law Reform” in Y. Gendreau, ed., *Mapping Society Through Law* (Montreal, Thémis, 2004), p. 119.

6. In focusing on questions relating to functionalism I do not mean to reduce the meaning of Article 9 reform to this specific question. Indeed, whenever the issue of “Article 9 exportability” is raised it is important to be clear about what the expression means: is the issue in view the Article 9 approach to scope (embracing title security within a broad functional logic)? Is it the approach to third party effectiveness through a comprehensive registration regime? Is it the particular approach that Article 9 takes to proceeds and real subrogation? Is it the Article 9 approach to enforcement remedies? Is it the Article 9 priority regime? For a more detailed discussion of these issues as they apply to civil law regimes, see M. Boodman and Roderick A. Macdonald, “How Far is Article 9 of the Uniform Commercial Code Exportable? A Return to Sources?” (1996), 27 C.B.L.J. 249.

transactions reform.<sup>7</sup> First, Quebec, where between 1985 and 1989 I served on a working group of the Ministry of Justice that vetted the security on property proposals of the Civil Code Revision Office (CCRO) and produced the first draft of what became Book VI: Prior Claims and Hypothecs of the 1994 Civil Code of Québec. Second, Ukraine, where in 2003 and 2004 I served as an external consultant for a World Bank initiative and assisted in the drafting of a new security on moveable property statute, entitled Law on securing creditors' claims and the registration of charges (Charge Law) that was proclaimed in force in January 2004.

### 1. Civil Code Revision in Quebec

In 1978 the CCRO proposed the adoption of an Article 9 type regime for Quebec. The relevant part of its Draft Civil Code (DCC) had the following features: (1) it placed the law of security on property in Book Four — Property; (2) it operated a horizontal integration of security devices, whether on moveable or immovable property; (3) it dealt with both consensual and non-consensual security in a unified regime and recommended the suppression of almost all non-consensual security; (4) it purported to govern not only true security devices, but also execution preferences and possessory liens as well; and (5) it brought all consensual devices (including title devices) under the rubric of a single concept — the hypothec — and provided for a uniform regime governing the creation, scope, effectiveness, third party effects, enforcement, and priorities of hypothecs.<sup>8</sup>

It would be seven years, two provincial elections, one referendum, one patriation process, and several Supreme Court of Canada constitutional decisions later before private law reform again captured the legal imagination in Quebec. In 1985 the Ministry of Justice struck a number of working groups to examine the various

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7. I should mention that I have also been a member (2001-2005) of the Canadian delegation to UNCITRAL's Working Group VI — Secured Transactions, which is charged with preparing a Legislative Guide on Secured Transactions, and a consultant (2003-2004) to a Canadian Internal Development Agency (CIDA) project on Civil Judgement Enforcement in Vietnam. Many of the more general observations in this article flow equally from these other law reform experiences.

8. See Government of Quebec, Civil Code Revision Office, *Draft Civil Code and Commentaries* (2 vols.) (Québec, Éditeur officiel du Québec, 1978), vol. I at pp. 257-99; vol. II, tome 1 at pp. 346-72 (introduction), pp. 425-504 (article-by-article commentary), pp. 532-34 (notes 4-46) and pp. 538-42 (notes 116-232).

books of the DCC. I was asked to join the group examining the recommendations relating to security on property.<sup>9</sup> The sub-committee met for four years. It commissioned a number of in-house studies examining the CCRO proposals (without first examining the office's own expert studies on these questions) and seemed to me to be particularly keen to explore whether these proposals were an unwelcome engrafting of the common law onto the civil law.

Because the DCC dealt with security on both moveable and immovable property, the notarial profession was strongly represented on the working group. Its representatives were sceptical about three features of the CCRO project: first, in extending the concept of the hypothec to moveables, the DCC appeared to operate a significant attenuation of the principle of the "*spécialité*" of the hypothec (deeds of hypothec had to specifically identify the property charged, the obligation secured, and the maximum value for which the hypothec could be claimed) especially in regards to universalities of property and future property; second, the DCC envisaged a reduced role for the notary, even in immovable transactions; third, in making all forms of moveable security respond to the logic of the hypothec, the DCC undermined the particularity of rules governing the existing panoply of moveable security devices — pledges, assignments of receivables, corporate trust deeds, floating charges, special non-possessory pledges and, after 1985, transfers-of-property-in-stock, etc. — a detailed knowledge of which and experience in their deployment constituted much of the expertise of notarial practice.<sup>10</sup>

In addition, because the project dealt with both consensual and non-consensual security, it attracted great interest from the representatives of the government, who sought to maintain many of the existing non-consensual priorities for powerful interest groups. Not

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9. *Comité d'étude sur les sûretés et la publication des droits réels*, the membership of which comprised two members of the Ministry of Justice (one advocate and one notary), the head of the Registration Service, one regional registrar, a representative of the Bar, a representative of the Board of Notaries, a representative of the *Fédération des notaires*, and a representative of the faculties of law in Quebec. Initially Professor Jacques Auger, a notary and professor at the University of Sherbrooke, was selected to serve on the working group, but following his appointment as a vice-rector of the University and upon his recommendation I was appointed as a replacement.
  10. For discussion of these concerns, and their impact on the draft legislation (*Avant-projet de loi*) that preceded the Code (Bill 106) see Roderick A. Macdonald, "The Counter-Reformation of Secured Transactions Law in Quebec" (1991), 19 C.B.L.J. 239.

least among these were the construction industry, which wished to maintain the non-consensual construction privilege, land developers who wished to retain a non-consensual privilege for condominium charges, municipalities and school commissions who sought to preserve their tax privilege, and the Quebec finance department for its own tax claims and levies. The CCRO had recommended abolishing the more than 50 such privileges and legal (non-consensual) hypothecs, while retaining only possessory (repairers', carriers', hoteliers') liens, and the unpaid seller's 30-day right of revendication, and as a fall-back alternative, a non-consensual construction hypothec.<sup>11</sup>

But most significantly, the working group was sceptical about two other features of the DCC proposal: the one being the opening of secured credit broadly to consumers by permitting non-dispossessory security over moveable property; the other being the adoption of a "functionalist" proposal for rationalizing transactions intended as security — the presumption of hypothec. Consumer groups were unable to see the similarity between a vendor's hypothec as the CCRO proposed and an instalment sale device; in particular, they did not appreciate that the regulatory regime of the Consumer Protection Act could be just as easily made applicable to hypothecs as well as sales, leases and service contracts. Furthermore, the notarial profession especially but also many rural real estate lawyers could only see a massive confusion arising from collapsing the distinction between title security and ordinary security on property. Part of the difficulty was that the "presumption of hypothec" proposal departed from the procedural logic that had previously driven secured transactions reform under articles 1040a-1040e of the Civil Code of Lower Canada (CCLC) — which tracked Article 9 and which could also be found in articles 14 and 15 of the Quebec Consumer Protection Act — to adopt an unfamiliar characterization or deeming logic.<sup>12</sup>

In the end, the ministerial working group came to the conclusion that it would not take the CCRO recommendations as a starting point.

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11. See Draft Civil Code and Commentaries, vol. II, tome I, *supra*, footnote 8, at pp. 353-72.

12. The differences between the Article 9 "substance of the transaction" approach and the "presumption of hypothec" are reviewed in Roderick A. Macdonald, "Faut-il s'assurer d'appeler un chat un chat? observations sur la méthodologie législative à travers l'énumération limitative des sûretés, 'la présomption d'hypothèque' et le principe de 'l'essence de l'opération'", in Ernest Caparros ed., *Mélanges Germain Brière*, Collection Bleue (Montreal, Wilson and Lafleur, 1993), p. 527.

In proposing an entirely new legislative framework, it significantly altered the DCC both as to form and substance. Rather than locate the proposals within the Book on Property, it proposed a separate book of the Code to deal with prior claims and hypothecs. Rather than abolish non-consensual security, it retained five prior claims and four legal hypothecs, including the legal hypothec for construction. Rather than seek a rationalization of consensual security and title security, it rejected the presumption of hypothec, and opted to provide for specific regulation of certain title devices — instalment sales, resolatory condition, sales with a right of redemption, finance leases, and at the last minute, security trusts — at the same time prohibiting the giving-in-payment (automatic mortgage foreclosure-type) clause.<sup>13</sup> Parenthetically, I might also observe that the drafting style adopted in the proposed legislation was a distinct disimprovement on the DCC.

I dissented from all these proposals, many of which seemed to emanate not from the deliberations of the working group itself, but from the other functionaries in the Ministry of Justice in Quebec City who seemed to me to be locked in the logic of the old CCLC regime of secured financing. In the end, the draft Bill (*Avant-projet de loi*) of 1989 that, with only minor revisions, ultimately formed part of the Civil Code of Québec was grounded in these internal ministerial proposals and not in the DCC. There were several reasons why this occurred.

To begin, the DCC was interpreted as entirely too much of a break from tradition for the Quebec legal professions of the time. Ironically, this resulted more from the CCRO's presentation of the proposals relating to security on property as a "new departure" than from the actual content of the regime. So, for example, the scheme of the DCC was sold by the CCRO as compatible with Article 9 and Canadian PPSAs, which led to the Minister and others declaiming (incorrectly) the "presumption of hypothec" as a common law incursion into some imagined pure civil law. For many at the time — recall that Quebec macro-politics of the period 1977-1990 were such as to give great weight to such allegations — transplanting into civil law Quebec an institution thought to be of common law origin

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13. The committee process by which these last minute additions to the Code were effected is discussed in Roderick A. Macdonald, "The Security Trust" in *Meredith Memorial Lectures: Contemporary Utilization of Non-Corporate Vehicles of Commerce* (Montreal, Faculty of Law, McGill University, 1997), p. 155.

would be almost as insidious as transplanting an English word into French.

In addition, some of the instincts and practices of a modern commercial economy were not widely disseminated in the Quebec legal professions, especially outside the major commercial firms in Montreal (most of which had English-language international — read common law influenced — corporate-commercial practices). These absent instincts dealt with ideas and concepts that secured transactions lawyers take for granted — future advances, after-acquired property, proceeds clauses, acquisition financing priorities, and so on. Transplanting into Quebec a complex and functionally organized regime of secured lending would be like transplanting an English grammar into a French *grammaire*.

Finally, because much commercial law was then contained in extra-codal legislation cast as exceptions to the regime elaborated in the CCLC, traditional Quebec private law legal culture at the time was neither familiar with nor particularly amenable to the conception of legal regulation imagined by the DCC. Several jurists opposed the idea of a regime of security on property that aimed at facilitating consensual transactions in which the principle of *numerus clauses* was not respected, in which creditors would be permitted to exercise self-help remedies and in which the jurisdiction of courts would be *ex post facto*, rather than *ex ante*. Transplanting into Quebec a predominantly voluntaristic regime of secured transactions law would be like transplanting English style and syntax into the literary world of the French novel.

Together, these points generate a fundamental conclusion about law reform through perceived legal transplants even as between relatively developed commercial economies. The more stable the political and legal environment, and the more that entrenched interests that have been successful norm entrepreneurs in the past have political power,<sup>14</sup> the more likely it is that doctrinal atavisms of conservative legal scholarship and traditional legal practice are able to derail reforms that threaten acquired intellectual capital in the name of preserving some presumed purity of the existing legal order.<sup>15</sup>

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14. On various theories of the legislative process that seem apposite to this experience, see W. Eskridge *et al.*, *Legislation and Statutory Interpretation* (New York, Foundation Press, 2000) especially at pp. 67-114.

15. A useful comparison might be drawn between two monographs written by and for practicing lawyers — J. Claxton, *Security on Property under the Civil Code of Quebec*

## 2. Secured Transactions Reform in Ukraine

My involvement in Ukraine was as an external consultant to a World Bank initiative — the Rural Finance Project — intended (despite the title of the project) to provide Ukraine with a basic legislative infrastructure governing areas as diverse as mortgage law, land registration, secured transactions, debenture lending, insolvency, bankruptcy, corporate finance, securities regulation and so on. My specific role was to assist in the drafting of a legislative regime relating to security on moveable property.<sup>16</sup>

Early in 2003, the Ukraine Supreme Rada (Parliament) had adopted in a first reading a law prepared by the Centre for the Economic Analysis of Law (CEAL).<sup>17</sup> This law was largely a copy of a similar law adopted in Romania several years earlier, and was modelled on Article 9.<sup>18</sup> After first reading, broad consultations with

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(Montreal, Yvon Blais, 1995) and L. Payette, *Les sûretés réelles dans le Code civil du Québec*, 2nd ed. (Montreal, Yvon Blais, 2002) with two monographs written by professors for students — D. Pratte, *Priorités et Hypothèques*, 2nd ed. (Sherbrooke, Éditions de l'Université de Sherbrooke, 2005) and P. Ciotola, *Droit des Sûretés*, 3rd ed. (Montreal, Thémis, 1999). The former are much more attuned to experimentation and making things work in practice; the latter to explicating the intellectual heritage of Quebec civil law. On this feature of Quebec property scholarship generally, see Roderick A. Macdonald, "Reconceiving the Symbols of Property: Universalities, Interests and Other Heresies" (1993), 39 McGill L.J. 761.

16. The circumstances that led to my being asked to participate in the process are revelatory of many of the underlying issues and political features of international commercial law reform. Early in 2003 I received a communication from the World Bank Office in Kiev soliciting my help in the re-drafting of legislation that had been rejected by the Bar and financial institutions as being incompatible with basic legal principles in Ukraine. The World Bank had heard of the Quebec experience, and of me, from a former LL.M. student who was contracted to work on the project. Presumably I was picked because I knew Article 9, spoke English and could bring the civil law template from Quebec to bear on the legislative re-draft. In other words, by the time I became associated with the project, it had already been decided that the North American chattel security regime to be imported as a model was that of Quebec and not Article 9.
17. For further information about the Centre and its various international legislative reform projects see <[www.ceal.org](http://www.ceal.org)>.
18. Law regarding some steps to speed up economic reform, Law No. 99 of May 26, 1999, a project of the World Bank (IBRD), as presented and discussed in N. Pena and H.W. Fleisig, "Romania: Law on Security Interests in Personal Property and Commentaries" (2004), 29 *Review of Central and East European Law* 133. As well as serving as the model for the initial secured transactions law in Ukraine, Article 9 (as instantiated in Romanian law) also inspired the Law amending the Civil Code, Notarial Law and other Laws, adopted by the Slovak Republic on August 19, 2003, as presented by Allen and Overy, *Guide for Taking Charges in the Slovak Republic* (EBRD 2003), and the Law on Registered Charges on Moveable Assets, adopted by the Republic of Serbia (Official Gazette, Republic of Serbia, No. 57/2003, May 30, 2003).

relevant stakeholders revealed that, however elegant the CEAL recasting of Article 9, and however coherent with the latest “law and economics” thinking about secured transactions, the proposed legislation was not going to take root in Ukraine. The World Bank then contracted with two local lawyers to revise the law for presentation to the Supreme Rada upon second reading in July. I was asked to comment on an early version of the revision, and then to spend two weeks in Kiev to help in fine-tuning it and to meet with members of Parliament, officials of the National Bank of Ukraine, the registry and others with a special interest in the project.

These consultations in June 2003 led us to the following conclusions about the form and content of the redraft. First, given that the Supreme Rada had just enacted a new civil code, which itself followed the enactment of a new pledge law, we felt we could not insert the reform directly into the civil code itself. Consequently, the new law would have to be drafted as a targeted overlay upon existing enactments that would only address key issues: the scope of security rights, publicity, priorities and enforcement.

Second, given that broad experimentation with all types of non-possessory rights and interests in moveable property was rampant, even well outside the traditional compass of secured transactions law, we felt that the new law should seek to provide some security of title in relation to all non-possessory interests in moveables. Consequently, the publicity regime was developed to embrace not just consignments and long-term leases, but all interests in moveables constituting an encumbrance on an owner’s rights (for example, usufructs) whether intended as security or not.

Third, given the perceived unreliability of and delays within the civil justice process, we felt the need to provide for the possibility of a complementary regime of private arbitration that would also produce third-party effects, combined with significant *ex ante* debtor-protection mechanisms to forestall aggressive foreclosures and realizations. Consequently, the concept of court in the law was defined so as to include accredited private arbitrators, a variation on the prior notice regime of the Civil Code of Québec was built into the enforcement regime, and creditors were entitled to enforce “judicially” without engaging the state execution service.

Fourth, we felt that the primary need of Ukraine was for a regime that dealt with security over equipment, inventory and receivables. Consequently, the legislative framework was designed with these assets in view, and was not finely tuned so as to provide detailed

regulation of security on second-generation incorporeal rights, deposit accounts and intellectual property.

In the end, taking these consultations into account, it became apparent that we could not simply rejig the CEAL Article 9 draft but would have to begin anew.<sup>19</sup> In a manner eerily reminiscent of the approach taken to the DCC in Quebec, it was decided to draft a law replacement that was more in line with the existing conceptual structure of domestic law.<sup>20</sup> Once again, there were several reasons why.

To begin, the basic conceptions of property and obligations in Ukraine are grounded in the Romano-Germanic tradition. Notwithstanding almost four decades of “socialist legality” Romanist conceptual distinctions between real rights and personal rights, between owing and owning, and between moveables and immoveables remained central in legal thinking. A “law and economics” approach to legal regulation simply misses the key lessons of 50 years of comparative law: law is not simply an independent variable and legal doctrine is not fungible. Transplanting Article 9 into civil law Ukraine would be like transplanting a pig’s liver into a horse.

In addition, and somewhat paradoxically in view of the above, after 70 years of “socialist legality” some of the instincts and practices of a market economy were not reflected in the legal regime of property and contracts in the Civil Code of Ukraine. These included ideas as fundamental as non-possessory general security on a universality of property that secured transactions lawyers in North America take for granted. The level of legal sophistication about

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19. For a detailed discussion of the features of the law as enacted see Roderick A. Macdonald, *Commentaries on the Law of Ukraine on Securing Creditors Claims and Registration of Charges* (Kiev, National Bank of Ukraine, forthcoming 2006), Part II.

20. While formally, the rejection of the CEAL draft and the DCC appear to be similar atavistic responses, the differences between the two processes were substantial. Most notably, even though often expressed in the language of “preserving the purity of the civil law tradition” the Quebec rejection was actually more the rejection by conservative elements of the profession of the substance of the reform being proposed, rather than the rejection of the conceptual form in which it was presented. By contrast, the Ukraine rejection presupposed the acceptance of the substance of the proposed reform, but a rejection of its mode of expression. For this reason, the Supreme Rada of Ukraine permitted our complete redraft of the CEAL proposals (which had already been adopted in first reading) to be introduced into the legislature as “second reading” amendments to those proposals — admittedly a highly unusual procedure in the circumstances.

commercial lending presupposed by Article 9 did not exist on the ground. Transplanting into Ukraine a complex and functionally organized regime of secured lending would be like transplanting a pig's liver into a canary.

Finally, it was not at all clear that there existed in Ukraine some of the basic conceptions of the rule of law that we take for granted as necessary preconditions to operable regimes of secured lending. If courts are slow and unreliable, if enforcement of judgments is haphazard, and if creditors are systematically rapacious, it is difficult to imagine how a secured financing regime can work. Far from a regime that loads substantial discretion upon courts to police *ex post* "good faith and commercial reasonableness", in such situations the greatest need is for *ex ante* "bright line rules". Transplanting into Ukraine a regime that presupposes parties will act according to the assumptions of a market economy would be like transplanting a pig's liver into an amoeba.

Let me emphasize the obvious conclusion as it relates to international law reform endeavours.<sup>21</sup> Much of the theory and general conceptualization of secured lending that permeates western systems, and which is present in international conventions, model laws and "draft legislative guides" such as those now being promulgated by various international norm entrepreneurs<sup>22</sup> is inapplicable to and unworkable in countries that find themselves in situations like Ukraine. Commentators who would make law subservient to economics misunderstand the relative autonomy of law in its two main western European variants. Efficiency cannot be a trump norm. Indeed, the point of a legal system (as opposed to a political system, an economic system or a social system) is precisely to organize decisions about social relationships on the basis of *ex ante* conceptual categories, and to eschew or at least constrain consequentialist reasoning in determining legal outcomes.

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21. On the limits of legal transplants as instruments of economic development, see generally, J.M. Miller, "A Typology of Legal Transplants: Using Sociology, Legal History and Argentine Examples to Explain the Transplant Process" (2003), 51 Am. J. Comp. Law 839; D. Nelken, ed., *Legal Culture* (Hampshire, Aldershot, 1996); B.Z. Tamanaha, "The Lessons of Law and Development Studies" (1995), 89 A.J.I.L. 470.
  22. The efforts of the World Bank (WB), Asia Development Bank (ADB), European Bank for Reconstruction and Development (EBRD), and the Organization of American States (OAS) as cited at footnote 1 are illustrative examples. But, for an example of a project that reveals much greater sensitivity to systemic issues, see <[www.uncitral.org/en-index.htm](http://www.uncitral.org/en-index.htm)> — Working Group VI — Secured Transactions (UNCITRAL).

### 3. Core Principles and General Policy Objectives

The success of the Article 9 model in North America has led many to believe that the goal of secured transactions reform is to replicate that regime as broadly as possible around the world. To do so, of course, would be to mistake the example for the principle. The true first-order policy goal is to modernize secured transactions regimes so that they may most efficiently achieve their key economic objective — namely, to promote the availability of low-cost credit. But this key objective is, itself, instrumental to larger purposes: to facilitate the successful operation and expansion of domestic businesses, to improve their ability to compete both locally and in the global marketplace, to enable consumers to acquire goods and services upon credit on the most favourable terms, and to do so in a manner that is consistent with other social and economic policies of the enacting state.

In other words, however important it may be to enact a regime that is effective, efficient and responsive to the needs of borrowers and lenders, transactional efficiency is not the only public good. Moreover, even though there is considerable evidence that, at least in post-Soviet states, the democratisation of debt goes hand-in-hand with the democratisation of politics,<sup>23</sup> the precise manner in which economic prosperity is balanced against other policy goals is a political choice about which states might reasonably differ.

Experience suggests nine *desiderata*<sup>24</sup> that should inform the elaboration of secured transactions regimes — whether in common

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23. It is a canon of the “law and development literature” that economic freedom induces political freedom, especially where states recover “dead capital” by establishing registration regimes for informal land holding. See H. DeSoto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York, Basic Books, 2000). As a universal principle, this triumphalism seems exaggerated to me, although the evidence from central Europe points in this direction. Compare A.O. Hirschman, “The On-and-off Connection between Political and Economic Progress” (1994), 84 *Am. Econ. Rev.* 343. For an application of the thesis to a “developed” country, see Roderick A. Macdonald, “The Governance of Human Agency Through Federal Security Interests” in H. Knopf, ed., *Security Interests in Intellectual Property* (Toronto, Carswell, 2002), p. 577.

24. These *desiderata* or core principles are derived from documents produced by, *inter alia*, the WB, ADB, EBRD, and the OAS, as well as from Roderick A. Macdonald, “Core Principles for a Regime of Security on Property” (unpublished document prepared for UNCITRAL Working Group VI — Secured Transactions, dated December 4, 2001) and Macdonald, *Commentaries, supra*, footnote 19, Part I. In the UNCITRAL legislative guide these *desiderata* are reframed as the following 11 key objectives: (1) promote

law or in civil law countries, or in states the law of which is not grounded in either of these European legal traditions. Before setting out these *desiderata*, let me observe that one should not polemically discount the Article 9 model. Many of its features are worthy of emulation and replication — at least at the level of overall structure and conceptual orientation — because they instantiate an optimal expression of the core principles and general policy objectives elaborated in the paragraphs that follow.<sup>25</sup>

(a) Coherence with Public Policy

A secured transactions regime grounded in freedom of contract and private property is a political choice that states make in order to achieve various distributional goals. Consequently, states should be entitled to establish the conditions under which different forms of wealth transfers as between classes of creditors (for example, secured, privileged and unsecured) should be permitted. While freedom of contract should underpin the law of security on property, it must be well integrated into the overall logic of debtor-creditor relationships adopted by particular states. In particular, because a secured transactions regime aims at the deployment of property to ensure the performance of obligations, it should not tolerate either direct enforcement against people — whether through slavery, debtor's prison, the impressments of future and unearned wages — or indirect enforcement against persons through legislative provisions making the simple failure to pay a debt a criminal offence.<sup>26</sup>

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secured credit; (2) allow utilization of the full value inherent in assets to support credit; (3) obtain security rights in a simple and efficient manner; (4) recognize party autonomy; (5) provide for equal treatment of diverse sources of credit; (6) validate non-possessory security rights; (7) encourage responsible behaviour by enhancing predictability; (8) establish clear priority rules; (9) facilitate efficient enforcement; (10) balance the interests of all affected parties; (11) harmonize secured transactions law internationally. See also F. Dahan and J. Simpson, "The European Bank for Reconstruction and Development's Secured Transactions Project: a model law and ten core principles for a modern secured transactions law in countries in Central and Eastern Europe (and elsewhere!)" in E.-M. Kienninger, ed., *Security Rights in Moveable Property in European Private Law*, *supra*, footnote 1, at p. 98.

25. Given space limitations, these paragraphs are necessarily telegraphic and lightly referenced. For more detailed discussion of their specific applicability to a non-western legal regime, see Roderick A. Macdonald, "Property, Identity and Governance" in *Towards Aboriginal Economic Modernity* (unpublished collection of papers prepared for the *Valorisation recherche Québec (VRQ)* research project *Autochtonie et gouvernance*) (A. Lajoie, coordinator) (2005).
26. This first *desideratum* is highly contested by many who believe that the primary if not exclusive goal of secured transactions reform is to promote credit. While many

## (b) Comprehensiveness

To the extent possible, a regime of security on property should be comprehensive as to all the elements of the security nexus — debtors (including consumers, merchants, public and private bodies, domestic and international lenders), creditors (funds, banks, private lenders, trust companies), obligations (to do, not to do, to give; consensual and non-consensual credit; present and future), collateral (moveables and immoveables, corporeal and incorporeal, present and future, individual assets and universalities), and legal origin of the security (contract or statutory grant). This will help minimize regulatory uncertainties or unfair inequalities of access to the regime, avoid creating inadvertent gaps in the regime, ensure the optimal integration of complementary legislation and promote cost competition among purveyors of credit. It will also prevent parties from manipulating their status, the character of their obligation or the legal nature of their assets so as to escape the regulatory regime.<sup>27</sup>

## (c) “Substance over Form”

In principle, the same regime of capacity to grant security, eligible collateral, pre-default rights and obligations, secured creditors’ recourses, and general theory of publicity of secured rights should apply regardless of the origin or form of the security right. The goal is to ensure that all transactions that either in intention or in effect deploy property to secure the performance of an obligation are treated similarly. This does not require that each such transaction be characterized as a security device. It only means that, whatever the characterization, the regulatory regime is not defeated by carve-outs grounded in conceptual formalism. The rights of creditors who seek

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acknowledge that states may have other legislative and political objectives that might influence the shape of a security regime, these are typically cast as being “extrinsic” to the regime — as if maximizing secured credit (and debt) were a self-evident good. See, for an example of such arguments, World Bank, *Principles and Guidelines for an Effective Insolvency and Creditor Rights Systems* (April 2001).

27. In this respect, the scope of a comprehensive regime of secured transactions should resemble that of an insolvency regime. Since one of the goals sought by secured creditors is a bankruptcy priority over other creditors, presumably the regime should attend directly to the right of non-consensual preferred creditors even outside bankruptcy. For further discussion of this point see Roderick A. Macdonald, “Le droit des sûretés mobilières et sa réforme: principes juridiques et politiques législatives” in P. Legrand, Jr., ed., *Common Law: d’un siècle l’autre* (Cowansville, Éditions Yvon Blais, 1992), p. 423.

to use title retention sales, leases, trusts and consignments to achieve a security right should be governed by rules that produce a functionally similar outcome to those regulating ordinary security devices.<sup>28</sup> Moreover, except where there is a compelling public policy rationale for differential treatment, the mechanisms of non-consensual security regimes should track those of consensual security.

(d) Promoting Party Autonomy

The logic of the regime should be as simple as possible and the legislature should decide questions having to do with definition and distribution of entitlements in the regime from an “ideal-type” perspective that permits enterprises to deploy assets to greatest advantage in the ongoing operation of their businesses. Technical barriers to contractual freedom that do not reflect a legitimate public policy goal should be eliminated. The regime should as closely as possible resemble the regime of rights and obligations that the parties would themselves choose to achieve their purposes. The regime should facilitate the granting and taking of non-possessory security, and procedural or technical barriers should not be used as an indirect alternative to direct legislative regulation where this is deemed necessary.

(e) Intelligible Rules

Rules should be drafted in a manner that is clear, comprehensive and intelligible not only to the legal community, but also to the relevant business community, and to citizens seeking to obtain or offer credit to and from one another. Public order or imperative rules should only be deployed to establish the basic structure of the regime. They should limit or prohibit choices only for reasons of unfairness or perverse distribution of burdens upon the parties or to third parties. Suppletive rules should be deployed only where the default regime closely models the choices parties would themselves make or where they can reduce the costs of negotiating security agreements by providing a template to facilitate contractual ordering — notably, where parties do not have access to expert legal

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28. A comprehensive discussion of both common law and civil law approaches may be found in M. Bridge, R.A. Macdonald, R.L. Simmonds and C. Walsh, “Formalism, Functionalism, and Understanding the Law of Secured Transactions” (1999), 44 McGill L.J. 567.

counsel and may not, therefore, be able to fully state their intention and expectations.

(f) Avoiding Fictions, Neologisms and Excessive Formalities

Legal fictions should be avoided, and neologistic expressions should not be used to redescribe relatively well-understood legal institutions. This is especially important where ideas are being transplanted from one legal tradition to another. The regime should not mandate an implied intent either by creditors or debtors. Nor should it presume or deem outcomes — for example, what is a commercially reasonable price upon realization — that can actually be determined by the operation of market principles. Since one of the key features of the regime is to give as broad a scope as possible for party autonomy, the expected benefits of all formalities (such as a notarial deed, or a canonical recitation in a document drafted by a lawyer) should be assessed against their costs as a limitation on party autonomy. Of course, formalities are sometimes necessary to achieve efficient outcomes; the point is simply that excessive formalism (especially where grounded in rent-seeking behaviour) is to be avoided.<sup>29</sup>

(g) Matching the Regime to the Internal Logic of Security

The regime should reflect the legitimate interests and expectations of debtors, creditors and third persons — where legitimacy is to be measured against the policy logic of a secured transactions regime. A key point is that the regime should not paralyze the capacity of the debtor to continue to deploy the unencumbered value of assets given in security to secure further credit advances. In addition, it should presume that most secured obligations will be performed as agreed and should structure incentives to encourage performance by debtors. It should give debtors a fair opportunity to redeem or re-instate the security — for example, by paying missed instalments and avoiding the application of acceleration clauses or other charges unrelated to the creditor's actual expectations on the secured obligation — and permit them to recover any surplus upon sale. Incentives should be structured to encourage cooperation in the event of debtor distress and not to allow precipitous creditor

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29. The above three principles are derived from D. Stevens, "The Reform of the Law of Immoveable Security in Quebec" in *Meredith Memorial Lectures: Current Problems in Real Estate* (Montreal, Yvon Blais, 1989), p. 419.

realization or interference with legitimate workouts by third parties. The regime should give creditors a deficiency claim where the proceeds of realization or value of a foreclosure are insufficient to liquidate the secured debt.

(h) Minimizing Transaction Costs

The regime should seek to achieve low transaction costs in creating, monitoring and enforcing security. The allocation of pre- and post- default rights and obligations should encourage responsible behaviour by the debtor or by any other person having custody or control of the secured collateral and should seek to maximize the realization value of the secured collateral. The pre-default regime should structure incentives so that the value of the collateral is maintained. It should discourage waste of the secured assets. It should provide incentives for the improvement of the collateral consistent with the terms of the security agreement. It should encourage the use and exploitation of the secured collateral as a revenue generator for the debtor.

(i) Maximizing Realization Values

The post-default enforcement regime should encourage responsible behaviour in the realization process by avoiding excessive state formalism in seizure and sale. Responsibility for execution of a task and liability for failure should generally be in the hands of the person who has the primary responsibility for seeing it completed. Realization rights should be limited by general norms of commercial reasonableness and good faith. Legitimate interests should be protected by giving third parties adequate notice of default and rights to ensure timely reinstatement or efficient enforcement. Creditors should be able to determine accurately the debtor's equity in collateral. Non-regular market transactions, such as a judicial sale, should be avoided except as a last recourse, and in all cases transactional finality should accompany realization recourses.<sup>30</sup>

(j) Conclusion

It is important not to be naïve about the desirability of these core principles and policy objectives, or about the possibility of their

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30. The three preceding principles relating to the internal logic of an efficient secured transactions regime are elaborated at length in D. Stevens and Roderick A. Macdonald, *Evaluating the Provisions of Bill 125 Relating to Preferences and Hypothecs* (Montreal, Chambre des Notaires du Québec, 1991).

realisation in any particular secured transactions regime. For example, even though many of these principles and policies seem to reflect Article 9 perspectives, even Article 9 does not pass full muster as against this template. Consider, for instance, whether Article 9 should be enlarged so as to cover immovable property and non-consensual security. Moreover, whether many of these principles are in fact desirable objectives depends upon particular political, social, legal and economic circumstances in enacting states. To take one example, it is not self-evident that a legal regime privileging self-help recourses will be optimal if the police and judiciary are susceptible to bribes. This said, of course, unless one undertakes the design of specific legislative regimes with these principles and policies in mind as aspirational standards, one risks simply copying rules enacted in some other state without considering whether they are likely to produce the effect desired. To practical considerations of this order I now turn.

#### 4. Implementation

The policy objectives pursued in modernizing secured transactions regimes can only be fully achieved if the legislation actually takes root. To ensure that it does requires attention to the multiple contexts within which the reform is meant to operate. States have quite distinct socio-economic-political systems. In addition, the types and actual role of credit institutions and the contractual practices attending to commercial law generally vary considerably from country to country. These considerations have generated a large literature on “legal transplants”.<sup>31</sup> Of course, the question in issue is not simply one of determining how to enact and cultivate a “legal transplant”. Many legal transplants (or at least parts of many legal

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31. The expression “legal transplant” was coined by Alan Watson, *Legal Transplants: an Approach to Comparative Law* (Edinburgh, Scottish Academic Press, 1974), and “Legal Transplants and Law Reform” (1976), 92 L.Q. Rev. 79. The basic terms of the debate about law reform through the borrowing of legal institutions and concepts were set at that time. For recent contributions to the debate see D. Berkowitz, K. Pistor and J.-F. Richard, “The Transplant Effect” (2003), 51 Am. J. of Comp. Law 163 and D. Berkowitz, K. Pistor and J.-F. Richard, “Economic Development, Legality, and the Transplant Effect” (2003), 47 European Econ. Rev. 165; Miller, “Typology of Legal Transplants”, *supra*, footnote 21; and D. Nelken, “Towards a Sociology of Legal Adaptation” and P. Legrand, Jr., “What Legal Transplants?”, both in D. Nelken and J. Feest, eds., *Adapting Legal Cultures*, *supra*, footnote 4, at p. 7 and p. 55.

transplants) do take root, but produce consequences quite different from those anticipated by enacting legislatures.<sup>32</sup>

Whatever the theoretical debate, law reform through legal transplants is a common strategy in the field of secured transactions. As a result, it is possible to identify a number of particular features that shape the success or failure of law reform in this area. The central implementation lessons learned from previous attempts at modernization of commercial law regimes may be summarized in 12 main themes, grouped under considerations of economics, social practices, legal structures and political decision-making.<sup>33</sup>

(a) Economic Issues

*Economic context and the role of credit institutions:* A secured transactions regime is not a free-standing field of legal regulation insulated from economic forces. It must be adapted to market practices of a jurisdiction. For example, in some countries, there is only a rudimentary trading economy: whether in the agricultural, manufacturing or light-industrial sector, the interpersonal confidence that makes the market for credit possible is absent. Moreover, many commercial debtors simply presume that they will not (or will not have to) repay future obligations they have contracted, especially when they are insolvent, or are on the threshold of insolvency. Simply importing legal regimes from one country to another without attending to underlying assumptions about credit granting and enforcement is perilous. Again, legal regimes such as those found in North America that presuppose open competition for credit, and relatively easy sources of enterprise refinancing, need to be adjusted for countries where a small number of institutions (sometime the national bank owned by the State) have a *de facto* or *de jure* credit monopoly or oligopoly.

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32. See the subtle discussion in Y. Dezalay and B. Garth, "The Import and Export of Law and Legal Institutions: International Strategies in National Palace Wars", in D. Nelken and J. Feest, eds., *Adapting Legal Cultures*, *ibid.*, at p. 241.

33. The following section is derived from R.A. Macdonald, "Considerations Relating to a Possible Chapter on Implementation" (document prepared for UNCITRAL Working Group VI — Secured Transactions, dated September 21, 2004). For a complementary discussion of these points that situates them within a general theory of law reform, see Roderick A. Macdonald and Hoi Kong, "Patchwork Law Reform: Your Idea is Good in Practice but it Won't Work in Theory" (forthcoming 2006, Osgoode Hall L.J.).

## (b) Legal Issues

*Where should this reform legislation be located?* Because a reformed secured transactions regime will be an enactment resting on basic concepts of private law, it is important to determine the nature and form of a country's "common law (*droit commun*)" of persons, property, contract and tort (*delict*). This is not a question about whether the regime is in the common law or civil law tradition, but is rather one of legal structure. In most market-type economies the "common law" takes one of three forms. It is either codified (as in continental Europe for example), or it is largely unenacted (as in the cases of the many autochthonous legal traditions), or it is constructed by an amalgam of several discrete statutes in particular areas of family, property, successions, obligations, etc. that rest on a largely displaced bed of unenacted common law (as in the case of most contemporary common law systems). If the regime is codified, a decision will have to be taken as to whether to integrate the reform into the civil code or keep it as a free-standing statute. The answer is not given simply by formal factors. For example, if a state has just enacted a new civil code, to replace the provisions on security on property would be disruptive to the stability of the code as artefact and therefore a separate statute might be preferable.<sup>34</sup>

*Attending to macro-legal architecture:* A secured transactions regime must also be adapted to domestic legal architecture. Not every jurisdiction deals with legal issues in the same place. Some treat problems of corporate governance in corporations' statutes, while others may regulate them in securities legislation. Again, some may deal with priority issues exclusively in secured transactions statutes, while others may also address them in a bankruptcy statute. One should not presume that rules governing security on property have to be enacted within a single statute that carries the label "secured transactions". Often particular security regimes are found in companies acts. In addition, some jurisdictions have separate commercial courts (with separate legal norms, rules of evidence, courts and rules of civil procedure) and still others have distinctive consumer protection rules and courts. If so, a choice will have to be made as to whether to cast the reform in generic terms,

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34. For a comprehensive treatment of the concept of a common law and its importance for statutory law, see H.P. Glenn, *On Common Laws* (Oxford, Oxford University Press, 2005).

or disperse its rules in separate statutes for enterprises and consumers, for example. Similarly, a choice will have to be made as to whether relevant rules of contract, property, debtor-creditor law and civil procedure should be set out in the reform statute or left within existing legislative or common law regimes.

*Conceptual Structure:* At a more *micro* level one must attend to the conceptual structure and methodological principles of a given legal regime. For example, if the regime rests on a general theory of the creditors' common pledge and distinguishes between non-consensual execution preferences that are simple priorities for payment and non-consensual security that has all the attributes of a consensual security regime, then it may be necessary to find a common model for non-consensual and consensual secured transactions. Or again, if the system generally tolerates party attempts to manipulate juridical status or the characterization of a transaction to profit from a *régime d'exception*, it may be necessary to look for more general structural norms to prevent acrobatic creditor activity and also to impede legislative attempts to subvert the priority regime. So, for example, if a regime is designed to provide detailed guidance for parties through suppletive rules, and trace out the normal course of events, it is important to consider how the legal system typically makes operational its structural norms meant to deal with the pathological cases. Does it rely on bright-line, *ex ante*, non-defeasible and non-waivable procedural rules, or does it deploy equitable, *ex post* liability rules that are couched with adjectives like reasonable, appropriate, fair, good faith, and so on?

*Principles of property and obligations:* More than this, a secured transactions regime must respect the fundamental concepts of obligations and property within a jurisdiction. For example, as long as a particular state maintains rigorous distinctions between owning and owing, and between real rights and personal rights, a unitary "substance of the transaction rule" in the manner of Article 9 that attenuates these distinctions for certain publicity and enforcement purposes cannot be imported directly. The substantive idea must be recast so that the goal of achieving functional equivalence may be realized through various provisions that respect the logic of the credit-provider claiming ownership. Similarly, where the regime conceives security on property as a real right, and therefore as subject to a *numerus clauses* of specifically identified legal institutions characterized by their "essential features", it is necessary to

develop an alternative to functional assimilation in order make it possible to even grant a security right in those assets of a debtor that are mere personal rights (leases, licenses, claims, etc.).

*The law of civil procedure:* The institutions and legal infrastructure of civil procedure — the process for liquidating obligations, exemptions from seizure, enforcement of judgments and execution priorities — also shape the possibilities for the regime. If realization of security is seen as part of the law of enforcement of judgments, non-consensual security rights, possessory liens and execution priorities must be integrated into non-judicial realization procedures. Further, if the regime starts from the principle *nul ne peut se faire justice à soi-même* considerable collateral reform needs to be undertaken to permit consensual realization. Even more importantly, one must account for how the system works in practice. If it can take three to four years to obtain a money judgment, and after that another year to obtain enforcement, and if there is no procedure to obtain interim and interlocutory orders, the regime cannot be based on premises that assume fast and efficient public enforcement mechanisms. Absent the development of *ex parte* and of interim recourses, or a system of expedited private arbitrations that produce third-party consequences, creditor-driven realization is not an option.

*Collateral regimes of corporate-commercial law:* A successful regime of security on property presumes its efficient integration with cognate regimes such as bankruptcy, banking, negotiable instruments, securities, intellectual property and interest regulation. For example, if the legal system generally understands the bankruptcy regime not as a collective liquidation procedure, but as an *ex post facto* device for rehabilitating debtors and reversing priorities that have been created in pre-insolvency situations, then a careful integration of rules relating to exemptions from seizure, social hold-backs and reserves for unsecured creditors will have to be established. Moreover, some jurisdictions provide for multiple procedures for dealing with insolvent entities — corporate winding-up statutes, bank, brokerage and insurance company liquidation regimes, the dissolving of state enterprises, to take common illustrations. Finally, various jurisdictions specially regulate negotiable instruments, intellectual property and securities so as both to limit the kinds of security rights that can be obtained and strictly regulate enforcement. Successful reform of secured lending law depends on integrating the modernized law with the policies promoted by these cognate regimes.

## (c) Social Issues

*On-the-ground practices of the law in action:* Simply because a new secured transactions regime is coherent with the general legal regime into which it is being projected is no guarantee that it will be successful. One must be attentive to one's assumptions about how debtors and creditors actually deal with legal principles, and assess whether these assumptions are operative in the receiving system. Here is an example. In some states there is little reluctance among merchants to invent proof and assertions of facts long after an event has occurred. In these jurisdictions accepting possession as a mode of "publicity" for secured rights risks abuse and a proliferation of transactions tinged with fraud, the true character of which might be either long or hard to prove in court. Deciding which principles of publicity and enforcement can be made to work in a given jurisdiction presupposes a keen sense of how these principles are likely to play out in practice and, on occasion, deciding that the field conditions necessary for their effective deployment are not present.

*Institutional and professional structure:* In addition to on-the-ground practices of parties, any reform must also take into account the practices of courts and related public institutions such as the sheriff's office or the state execution service. Sometimes a lack of confidence in the regime of security on property results from a quite justifiable lack of confidence in the legal system as a whole. Where the idea of an impartial and independent judiciary does not form part of the constitutional order, where judges can be bribed, or where their legal education does not equip them to interpret and apply complex legal prescriptions, the reform has to be tailored to provide for alternative adjudicative possibilities such as commercial arbitration. Like alternatives may also have to be imagined where all aspects of the realization process, up to and including execution of judgments, are in the hands of state officials. Similar considerations bear on the legal professions. In many states, notaries have traditionally played an important role in the field of security on property, such that incorporating them into the regime may be necessary for successful implementation. Conversely, in some countries the profession of advocate is both unlicensed and unregulated. In such contexts, legislation delegating significant ethical judgment to lawyers may be unwise.

*The diffusion of legal knowledge:* A secured transactions regime must be sensitive to the sophistication of business activity, the state

of capital markets, the nature of entrepreneurship, and the general diffusion of legal knowledge within the state. For example, in some countries, the general level of entrepreneurial acumen is rudimentary. Worse, there are states where the notion of capitalist entrepreneurship has acquired decidedly rapacious if not corrupt and thuggish undertones and where credit purveyors do not hesitate to use brute force to realize upon secured assets. Expressly providing a surfeit of private coercive creditors' rights in such situations may not conduce to an efficient, let alone equitable, regime. Again, in some countries there are simply not enough lawyers to provide transaction-specific advice to clients who wish to borrow (or even local lenders), and therefore the regime has to be designed so it can be operated by those — such as local bank managers or loan officers — who may not have a formal legal training. Typically this requires the enactment of a greater number of non-waivable structuring rules, a fairly comprehensive and detailed regime of suppletive rules, and the provision of mandatory, fill-in-the-blank forms.

(d) Political Issues

*Attending to political culture:* The most important consideration in any law reform exercise is that the proposals respect the political culture of the country in question. Here is an example of why this is a complex public policy issue. The widespread use of private social insurance programmes in North America means that a secured transactions regime here can be designed to favour lenders to the exclusion of the state (or its agencies); but in many countries, it is only by maintaining a priority entitlement in bankruptcy that these programmes can avoid insolvency themselves. One cannot assume that all states will locate responsibility for providing basic social services on the same side of the public-private divide. The matter is further complicated because the state is often one of the abusers of the priority system through its systematic deployment of secret liens and *ex post facto* senior charges. Since the goal is to provide for the most efficient, low-cost regime of secured lending possible within the framework of the political choices made by individual states about the organization of their economies, the regime has to be designed to permit states to use non-consensual priorities to achieve social policies, while at the same time integrating these within a transparent publicity regime that minimizes uncertainty for creditors.

## (e) Pragmatic Issues

*The perfect is the enemy of the good:* The above considerations are meant to signal the relativity of all secured transactions reform. North American norm entrepreneurs who seek directly to incorporate into the law of another state certain relatively refined principles with which they have become familiar tend to downplay the extent to which domestic law influences legal regimes. It is not possible to enact fine-grained legislation relating to security on property until there is broad consensus about and acceptance of basic operative principles of a modernized secured transactions regime. Concomitantly, jurists in adopting states who wish to see their own law reflect current developments in the developed commercial jurisdictions must appreciate that the present version of Article 9 is its third iteration and that borrowers and lenders in the United States have had more than 40 years to work through its logic and principles. While some states can immediately adopt reform projects that rest on the same assumptions about the character and capacity of the economy, the market for credit, the ambitions and structure of the legal professions, and the expertise of the judiciary that drive North American law, this will not invariably be the case. Many states need to start with a bare-bones regime (using bright-line rules and imperative contractual provisions) that deals primarily, but effectively, with hard assets (equipment, inventory) and receivables. Frequently, establishing a well-functioning Toyota Tercel model of secured transactions is better than legislating a Lamborghini that cannot be kept in working order.

## (f) Conclusion

The various considerations just reviewed cannot be reduced to a formula or a template against which enacting legislatures can assess the merits or demerits of any specific proposal for secured transactions reform. There are two reasons for this. First, each one implies the exercise of judgment: the weighing of the relative significance of a given factor within an overall legal framework. So for example, a state with developed social welfare programmes might wish to adopt a lender-friendly secured transactions regime precisely to change the relative mix of public and private health, employment and pension regimes. Or, where a particular profession has a monopoly over certain types of transaction, a state may wish to reduce the economic power of the profession by eliminating this

monopoly. Simply because states must attend to on-the-ground conditions does not mean that successful law reform depends on them maintaining the *status quo*.<sup>35</sup>

The second reason that militates against a formulaic approach is this. The precise nature of most of the contextual factors identified will be highly contested. If one group of experts claims that legal knowledge is insufficiently diffused in the business community to permit a fully consensual secured transactions regime, there is certain to be another group that asserts the contrary. Or, if one group of scholars asserts that the reform should be integrated into a civil code in order to give it symbolic weight, another is just as likely to assert that it should be enacted as special legislation that can be more easily amended until all its wrinkles are ironed out. Both those who argue for the impossibility of legal transplants and those who claim that the specialized character of the knowledge possessed by legal *élites* makes transplantation relatively unproblematic are given to monochromatic assertions about the context of law reform. By contrast, jurists who have actually participated in the international law reform process, and then stuck around to assess the effects of their handiwork are much more sanguine about the "recipe book" approach.<sup>36</sup>

## 5. Acculturation

Traditionally law reformers believed that their mission was accomplished once legislative implementation had been achieved.<sup>37</sup>

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35. For an application of these various considerations to secured transactions reform in Quebec see Roderick A. Macdonald, *The Law of Security on Property in Quebec: Part One* (Montreal, McGill University Faculty of Law, 1994). For their application to Ukraine, see Macdonald, *Commentaries, supra*, footnote 19, Part I.

36. The issues are nicely framed by R. Cotterell, "Is There a Logic of Legal Transplants?", and L. Friedman, "Some Comments on Cotterell on Legal Transplants", both in D. Nelken and J. Feest, eds., *Adapting Legal Cultures, supra*, footnote 4, at p. 70 and p. 93.

37. For a comprehensive account of the traditional approach to law reform and implementation, see W. Hurlburt, *Law Reform Commissions in the United Kingdom, Australia and Canada* (Edmonton, Juriliber, 1986); W. Hurlburt, "A Case for the Reinstatement of the Manitoba Law Reform Commission" (1997), 22 *Man. L.J.* 215; and W. Hurlburt, "The Origins and Nature of Law Reform Commissions in the Canadian Provinces" (1997), 35 *Alta. L. Rev.* 880. Alternative objectives and measures of law reform success are discussed in R. Samek, *The Object and Limits of Law Reform* (unpublished study prepared for Law Reform Commission of Canada, 1976). The often tenuous relationship between enactment and effective implementation is explored in B. Opeskin, ed., *The Promise of Law Reform* (Sydney, Australian Law

Today, however, the central question is not: “has a law been enacted?” It is, rather: “what on-the-ground effects has a particular law reform endeavour generated?”<sup>38</sup> Much contemporary reflection on evaluation concludes that a prerequisite to successful law reform — that is, law reform that achieves its stated purposes — is acculturation.<sup>39</sup>

Acculturation arises at two moments. First, any particular law reform endeavour needs to be sold. If the strategic option is to proceed with legislative law reform, the project obviously has to be sold to politicians and in particular to the relevant minister of the government in power. Unless he or she is willing to make the reform a priority, it will not make the cabinet’s legislative agenda. Norm entrepreneurs therefore need to ensure that the project is supported by the relevant client community (in the jargon today “stakeholders”) and by the principal lobby groups that can influence politicians. By contrast, if the strategic option is to proceed with non-legislative law reform an appropriate climate for activist judicial decision-making must be created. As well, lawyers and their clients have to be persuaded to engage in strategic litigation meant to drive the reform agenda.<sup>40</sup>

But the exercise of salesmanship does not end at the moment legislation is enacted. Statutes are not usually self-executing. Once the reform is proclaimed in force, governments have to invest in the legal infrastructure — in the instant case, primarily the registry

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Reform Commission, 2005). See also Roderick A. Macdonald, “Recommissioning Law Reform” (1997), 35 *Alta. L. Rev.* 735.

38. In the sociology of law, this is known as effectivity — the actual consequences both desired and undesired, both foreseen and unforeseen — of a rule. See G. Rocher, “L’effectivité du droit” in A. Lajoie *et al.*, eds., *Théories et émergence du droit: pluralisme, surdétermination et effectivité* (Montreal, Thémis, 1995), p. 133.
39. For a subtle analysis of evaluation frameworks in law reform see the documents assembled by the Evaluation Division of the Department of Justice of Canada, available online at <<http://www.justice.gc.ca/en/ps/eval/index.html>>. See also Treasury Board of Canada, *Evaluation Policy*, available online at <[http://www.tbs-sct.gc.ca/pubs\\_pol/dcgpubs/TBM\\_161/siglist\\_e.asp](http://www.tbs-sct.gc.ca/pubs_pol/dcgpubs/TBM_161/siglist_e.asp)>.
40. Consider the interest-group thesis of M. Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, Harvard University Press, 1965) as applied to the legislative and judicial processes in the light of G. Peller, “The Metaphysics of American Law” (1985), 73 *Cal. L. Rev.* 1151; P. Shuck, “Against (and for) Madison: An Essay in Praise of Factions” (1997), 15 *Yale Law & Pol’y Rev.* 553; and J. Mashaw, *Greed, Chaos, and Governance: Using Public Choice to Improve Public Law* (New Haven, Yale University Press, 1997). The failure of the security on property provisions of the CCRO’s Draft Civil Code to achieve enactment in Quebec just as much as the immediate enactment of the Charge Law in Ukraine can be largely explained by interest-group and new-institutionalist theories of political action.

system — required to make the regime work. To affirm that a law reform effort has been successful is to make a claim about its effectivity as a regulatory endeavour. Success implies that: (1) the regime is deployed in practice — that is, that it actually manages to capture the imagination and earn the confidence of lawyers and entrepreneurs as an efficient and effective means of structuring their lending and borrowing affairs; and (2) the regime is properly understood and interpreted by all those who are called upon to make it operational — lenders, borrowers, lawyers, bailiffs, sheriffs, registrars, and above all, judges and arbitrators. Put slightly differently, successful law reform occurs when the effectivity of a statute matches the legislature's desired effectiveness (efficacy).<sup>41</sup>

The necessary post-enactment acculturation to achieve effectiveness does not result from happenstance. It requires a concerted effort in several dimensions, all of which are quite variable in both scope and importance, depending on the character of the state where the reform endeavour occurs. Not surprisingly, however, as a general rule these several dimensions track what are typically called sources of law in civil law jurisdictions: custom, usage and professional practice; jurisprudence (or decided cases); doctrine. To these three normative sites of legal acculturation may be added a fourth: institutional, professional and continuing legal education.

(a) Custom, Usage and Professional Practice:  
Precedents and Forms

Most of the transactions that will be entered into under a revised security on property regime will be variations on recognized contracts. That is, in the first instance they will be generated by emendations and deletions from existing standard form documents and precedents relating to the granting of security, subordinations, collateral guarantees, waivers, enforcement notices, sale notices, collocation orders, and so on. This reliance on existing documentary forms is not necessarily helpful, since atavisms, redundancies and inconsistencies carried forward from previous usages are likely

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41. The distinction is nicely drawn in E. Blankenburg, "La recherche de l'efficacité de la loi : Réflexions sur l'étude de la mise en œuvre : le concept d'implémentation" (1996) 2 *Droit et Société* 59; P. Lascoumes and E. Séverin, "Théories et pratiques de l'effectivité du Droit" (1996) 2 *Droit et Société* 101; and M. Garcia Villegas, "Efficacité symbolique et pouvoir social du droit" (1995), 34 *Revue interdisciplinaire d'études juridiques* 155.

to clutter these precedents for several years after the new law comes into effect, as experience in Canada's PPSA jurisdictions attests. Moreover, it is not just parties and their counsel who are required to generate new formularies. The state and its officials must also produce the forms necessary for filing in the registries (which will often be simply electronic templates).

In both Quebec and Ukraine, the sponsoring ministries quickly developed the electronic forms for registration. They did not, by contrast, take on the project of developing transactional precedents. Nor did the National Assembly or the Supreme Rada enact such precedents. This task was undertaken by law firms and, in the case of the notarial profession in Quebec, by the professional corporation itself, which produced an excellent series of precedents especially for real estate secured lending. Nonetheless, especially in states with emerging market economies, developing an official series of purely indicative draft documents for modification by lawyers is an important educational step in ensuring that the learning of the new law quickly percolates through the legal profession as well as the business and finance communities.

(b) Jurisprudence: Reporters, Annotators,  
Information Clearing Houses

Immediately upon enactment of legislation, lawyers will litigate. Depending on the normative status of decided cases as a source of law in a particular jurisdiction (*stare decisis* or *jurisprudence constante*, for example) access to decided cases will be more or less important. Moreover, to the extent that arbitration of disputes involving security rights is permitted, these decisions should also be brought into the public domain. In many countries that have reformed commercial law and the regime of security on property, there quickly develop privately organized informational clearing houses. For example, there exist a UCC Law Review, a PPSA Law Review, and a series of law reports devoted to Article 9 and to the PPSA. Still, several states at this point have underdeveloped resources for reporting, indexing and commenting on judicial decisions.

In Quebec, the community of private law publishers quickly developed a series of commercial products — annotated Civil Codes, reporting series, etc. In Ukraine, by contrast, the law publishing industry is not nearly as developed and access to cases,

whether in print or through online reporters, remains hard to come by. For states without an enterprising legal publishing establishment, successful acculturation demands an initial public investment in these types of clearing houses, preferably online, in order to ensure that the informational base in relation to the reformed legislation is up-to-date and sophisticated.

(c) Doctrine: Treatises, Manuals, Commentaries, Case-notes

It is typical in civil law countries for major pieces of legislation to be accompanied by official commentaries prepared by the sponsoring ministry. Sometimes these are rudimentary, but where a Code or other major piece of legislation is enacted they can be quite extensive. As such they serve an important role in aiding lawyers and judges to understand the rationale and the logic of particular provisions of the law. In addition, new legislation is almost always best understood when there appear doctrinal commentaries that attempt to explain the law, relate it to previous regimes, suggest where existing rules have been explicitly or implicitly overruled, or carried forward, and indicating how to structure agreements within the new law in order to achieve a client's objectives. Finally, detailed (even critical) doctrinal commentary serves a legitimating function that serves to reinforce the message of law reform carried by an enactment.

In Quebec, the Minister of Justice produced a two-volume series of Official Commentaries to accompany enactment of the Civil Code of Québec, and the Bar and Board of Notaries jointly sponsored the production of a three-volume set of doctrinal commentaries on the new code, including two separate commentaries of secured transactions, both of which were soon transformed into free-standing monographs.<sup>42</sup> In Ukraine, the World Bank, having

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42. See *Commentaires du ministre de la Justice* (two vols) (Québec, Les Publications du Québec, 1993), and the essays by an advocate, Louis Payette, and a notary, Pierre Ciotola in *La réforme du Code civil*, tome III (Québec, Presses de l'Université Laval, 1993), p. 9 and p. 303 — a collection sponsored jointly by the Bar of Quebec and the Quebec Board of Notaries. These essays quickly were transformed into monographs: see L. Payette, *Les sûretés réelles dans le Code civil du Québec*, *supra*, footnote 15, and P. Ciotola, *Droit des Sûretés*, *supra*, footnote 15. In addition to these two monographs, three other monographs have been published since the Civil Code of Québec was enacted. See J. Claxton, *Security on Property under the Civil Code of Quebec*, *supra*, footnote 15, D. Pratte, *Priorités et Hypothèques*, *supra*, footnote 15, and M. Boudreault, "Les sûretés" in *Répertoire de droit/Nouvelle série "Sûretés" Doctrine* — Document 1 (Montreal, Chambre des notaires du Québec, 1997).

promoted the reform and shepherded it through the legislative process, then commissioned a legislative commentary (in English and Ukrainian) on the new law.<sup>43</sup> In order for doctrinal commentary to best serve its role as an acculturation mechanism there should be at least two competing sets of commentaries so that scholarly debate about the scope and interpretation of the reform can be engaged.

(d) Education: Professional Training, Refresher Courses,  
Law Faculties

The endeavour of legal education is ongoing. As soon as a new law comes into force, lawyers, their clients, and public officials such as sheriffs, bailiffs, registrars and judges are required to interpret it. Apart from those few jurists who worked on the reform, most will have limited prior knowledge of the law. This means that bar associations will have to produce materials, run seminars and conferences and provide different forms of basic consultative services in order to re-educate the profession about the requirements of the new law. Moreover law faculties need immediately to develop courses and teaching materials dealing with the new regime of hypothecs on moveable property. Ensuring that the teaching of secured transactions law in law faculties is attuned to the new regime is essential to ensuring its viability as a reform endeavour — that is, to validating the legislative endeavour — and to enabling law firms to quickly adjust to the new regime.

At the time the Civil Code of Québec came into force both professional corporations imposed mandatory continuing education courses on their members. In addition, law faculties were quick to adjust their undergraduate curriculum and to offer multiple series of continuing education seminars and conferences for the professions. As with a similar endeavour in PPSA jurisdictions, within a couple of years, law firms came to rely on their younger recruits to paper transactions under the new regime. In Ukraine, there is no organized Bar in the traditional sense, and so there is no ongoing monitoring of professional competence in relation to the new law. Moreover, while law faculties quickly began to teach the new law in relevant courses, they have been slow to develop continuing education programmes for lawyers, arbitrators and judges.

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43. Macdonald, *Commentaries*, *supra*, footnote 19, Part II.

### III. HOW FAR FUNCTIONALISM?

I turn now to my second general point. My experiences in Quebec and Ukraine cause me great concern about the tendency in modern law to replace conceptual analysis with unconstrained functionalism, and to sacrifice *ex ante* categorical reasoning on the altar of consequentialist reasoning. Of course, I do not deny that the application of legal concepts to lived experience — the exercise of characterisation — inevitably involves asking teleological or functional questions. But the point is to ask these questions by reference to the criteria — typically of structure or pedigree or stipulated essence — that one has elaborated to define a concept. For example, in order to determine if a contract is a sale, one first looks to what the law defines such a contract to be: in the civil law, sale is an agreement that is consensual not formal, bilateral not unilateral, onerous not gratuitous, and of instantaneous not successive performance. A lease does not become a sale simply because the term of the lease extends to the effective life of the object leased, and the total value of the lease payments is equal to the amortized cost of acquisition of the object.

Likewise, I do not deny that legal analysis should always be tested by reference to the consequences that it produces. Simply because the normal legal consequences of a lease are different from those of a sale does not mean that a legislature can never — even where the economic functionality of a particular lease is identical to that of a sale — enact a legal rule that puts the two transactions on an identical footing. But the vector of concept to consequence should not be reversed: consequences are confirming, not the structuring condition.

Let me put the point slightly differently. What distinguishes legal analysis from social, economic and political analysis is the fact that, in the former, law is conceived as at least a semi-independent variable — as meant to produce social, economic and political consequences, while in the latter, law is conceived as an almost entirely dependent variable — social, economic, moral and political factors produce law.<sup>44</sup> My argument here is simply that *ex post facto* or

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44. So, for example, a legal analysis of the (de)criminalization of recreational drugs would ask what regulatory models were available as alternatives (open markets, licensing sellers, licensing buyers, etc.) and what on-the-ground outcomes a changed regulatory strategy could be predicted to produce. By contrast, an economic analysis would ask whether the costs of criminal prohibition were justified by the benefit they

consequentialist reasoning has its limits, and we do a disservice to the vocation of law by making functionalism the trump value in all legal analysis.<sup>45</sup>

At the systemic level, unconstrained functionalism has four consequences: first, it means that the value of legal rules in providing facilitative guides for self-directed human interaction is undermined — who knows when courts will second-guess legislatures or radically depart from an established precedent? Second, it means that the planning, dispute channelling and dispute avoidance function of contract is compromised — who knows whether the terms of a contract will be enforced? Third, it means that the complex balancing of multiple interests characteristic of distributive justice in the rule-making arena stands to be trumped by the single-minded adversarial concerns of self-interested litigants; and fourth, it means less investment in pursuing high quality legislative law reform — why spend energy trying to get a legislature to think epidemiologically about the design of regimes of legal regulation, when one can simply go to court with a sob-story and obtain, on an *ad hoc* basis, the desired outcome?

These various consequences are patent when one considers the causes, archetypes, trajectories and outcomes of consequentialist functionalism in the definition of a security right in different common law and civil law countries.<sup>46</sup> Myths abound. Many Article 9

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produced and whether some other strategy might be more efficient, a public health analysis would look to harm reduction as the policy goal that should drive legislative action, and a moral analysis would decide the criminalization question by reference to some set of principles of right conduct. For a review of these approaches to the regulation of recreational drugs and their implication for policy analysis see Roderick A. Macdonald, *The Governance of Human Agency* (background paper prepared for the Special Committee on Illegal Drugs, Senate of Canada, 2003).

45. I have argued this point at greater length in Macdonald, "Triangulating Social Law Reform", *supra*, footnote 5, at p. 121.
46. There is a second order point as well. Functionalism has become a preferred methodology for comparative law and harmonization projects. Following the lead of the great comparativist, Rudolph Schlesinger, the promoters of the Trento project for the unification of European private law have adopted functionalism as a guiding ideology. See M. Bussani and U. Mattei, eds., *Making European Law: Essays on the "Common Core" Project* (Trento, Universite Trento, 2000), and V. Curran, "On the Shoulders of Schlesinger: The Trento Common Core of European Private Law Project" (2003), 1 *Eur. Rev. Private L.* 66. The project is, however, not without its critics. See notably, P. Legrand, Jr., "Against a European Civil Code" (1997), 60 *Mod. L. Rev.* 44; "European Legal Systems are not Converging" (1996), 45 *I.C.L.Q.* 52; "On the Unbearable Localness of the Law: Academic Fallacies and Unseasonable Observations" (2002), 10 *Eur. Rev. Private L.* 1, at p. 61; "Sur l'analyse différentielle

proponents delight in castigating those trained as civil lawyers for their unthinking conceptualism, formalism and incapacity to engage in functional analysis, as if functional analysis were somehow foreign to the civil law tradition. Conversely, many civil law jurists imagine the common law as an unorganized heap of single instances each decided *ex aequo et bono* or as a morass in which consequentialist reasoning dominates. My aim in this section is to illustrate that the real choices opened up by reflection on differences between the Article 9/PPSA and Quebec/Ukraine approaches are not choices about formalism or functionalism, but rather choices about the location and level at which functional analysis should take place.<sup>47</sup>

Before doing so, however, it is worth attending to the concept of a “security interest” under the Article 9/PPSA schema or of “security on property (*sûreté réelle*)” in contemporary civil law formulations. Surprisingly, in no jurisdiction I have canvassed — whether in the common law or the civil law tradition — does one find a legislative definition of the concept. From cases and doctrinal commentary, however, one can deduce the following:

A security interest is constituted by the specific and purposive affectation of property to the satisfaction of a debt in a manner that improves the legal situation of a creditor by palliating the principle that an insolvent debtor’s entire estate is the common pledge of creditors.<sup>48</sup>

Both in the common law and the civil law, it is necessary to determine when any particular legal transaction falls within this definition, and

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des juriscultures” (1999), R.I.D.C. 1053. For a balanced perspective, see N. Kasirer, “The Common Core of European Private Law in Boxes and Bundles” (2002), 10 *Eur. Rev. Private L.* 3 at p. 417. Most projects for modernization of commercial law in Central and Eastern Europe implicitly adopt the Trento thesis, in that they take “functional equivalence” as the organizing principle — where the standard against which to assess equivalence is economic efficiency.

47. For a detailed comparison of both unreformed and reformed common law approaches to the definition of a security interest, with both unreformed and reformed civil law approaches to the same issue, see Bridge *et al.*, “Formalism, Functionalism”, *supra*, footnote 28.

48. This definition is drawn from J.-F. Riffard, “Propriété et garanties: faut-il destituer la reine des sûretés?” in *L’apport du Guide législatif de la CNUDCI à la réforme du droit des sûretés: Actes du colloque de Clermont-Ferrand — Banque et droit*, no. 97, sept-oct 2004, who in turn develops it from P. Crocq, *Propriété et garantie* (Paris, L.G.D.J., 1995), tome 248, and P. Simler and P. Delebecque, *Droit civil: les sûretés; la publicité foncière*, 4th ed. (Paris, Dalloz, 2004). See also Roderick A. Macdonald and J.-F. Ménard, “Credo, credere, credidi, creditum: Essai de phénoménologie des sûretés réelles” (forthcoming, *Mélanges François Frenette*, 2006).

in neither can this determination take place solely by reference to the legal form of the transaction. Enter functionalism.

### 1. Common Law Functionalism

Historically, common law systems possessed relatively impoverished regimes of secured transactions. Consider the paradigmatic common law security right — the real estate mortgage. The idea of the mortgage is to transfer title to property conditionally to a creditor as security for a debt. What is interesting about the mortgage is that it reflects the deployment of one of the most fundamental of legal *concepts* (ownership) for a collateral and more sophisticated legal *purpose* (security).<sup>49</sup> For obvious reasons, courts of Chancery immediately began to interfere with the contractual freedom that such a right implied, developing the notion of an “equity of redemption” as a property interest itself capable of being mortgaged, debtor-protection principles such as “no clogs on the equity of redemption” and a functional characterization rule “once a mortgage, always a mortgage”.

Two features of the evolution in judicial doctrine are noteworthy. First, the absence of a separate, well worked out concept of non-possessory security (the Roman law idea of hypothecation) meant that courts had to build up the various attributes of the idea on a step-by-step basis. Here, common law judicial method and a functionalist approach were perfectly coherent. Not having an *ex ante* conceptual frame to guide their law-making activities, the courts of equity took an incremental approach to developing the characteristics of the mortgage, its third party effects, and the obligations — notice of enforcement, preserving the right to reinstate — they might logically impose on creditors.

Second, the fact that courts were pursuing a functionalist logic to transform a legal transaction that rested on the transfer of ownership to a creditor also meant that they were not constrained by legal form in applying their conception of a mortgage to any other legal transaction that had a similar purpose. That is, to derive the notion of a mortgage in the first place courts had to deny that legal form was controlling. Not seeing a radical, unbridgeable distinction between

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49. The story of the origins of the common law mortgage is murky. For one interpretation that suggests the influence of Talmudic Law see J.J. Rabinowitz, “The Common Law Mortgage and the Conditional Bond” (1943), 92 U. Penn Law Rev. 179 and “The Story of the Mortgage Bond” (1945), 94 U. Penn. Law Rev. 94.

contingent ownership and true security (for example, a pledge) they were able to extend debtor-protection rules applicable to mortgages to any transaction that functioned like a mortgage.<sup>50</sup> In brief, reasoning by analogy in the courts of Chancery was not, in the language of Max Weber “formally rational” and constrained by *ex ante* conceptual category, but rather instantiated “substantive rationality” and was driven largely by teleological considerations.<sup>51</sup>

During the 19th century, the limits of this approach began to be felt, especially in the realm of personal property, as lawyers, courts and legislatures each conspired to create legal devices meant to achieve the effect of security. Yet, with the possible exception of the floating charge, no effort was invested in trying to discern or rationalize what exactly the generic concept of security on property entailed. Only in the latter half of the 20th century did this rationalizing project emerge with the advent of Article 9. Rather than continue to build a patchwork of legal regulation or to extend old concepts to new and analogous legal situations where debtors also merited protection against unfair creditor practices, the drafters of Article 9 chose to impose an additional layer of conceptualism organized on functional criteria. In both Article 9 and the PPSAs the regulatory regime was meant to apply to any transaction that, regardless of its form, in substance created a security. Hence the slogan: “if it walks like a duck and it quacks like a duck, the law should treat it as if it were a duck”.<sup>52</sup>

Notice, however, five significant features of the Article 9 formulation as instantiated in ss. 2 and 4 of the PPSA of Ontario. First, notwithstanding the claims of some doctrinal commentators, no new legal concept called a “security interest” was legislatively announced or created. The statute simply announced its applicability where any legal concept was deployed to create what in substance was security — including, for example, existing institutions like chattel mortgages, conditional sales agreements, consignments,

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50. Of course, in some cases the legislature also had to intervene to impose third party publicity requirements or enforcement formalities, although even in respect of conditional sales, hire-purchase agreements, leases with option to purchase, etc., courts were able to invent workable regimes. See Lionel Smith, “Security” in Peter Birks, ed., *English Private Law* (Oxford, Oxford University Press, 2000), p. 385.

51. See M. Weber, *Law, Society and the Economy* (M. Rheinstein, trans.) (Chicago, University of Chicago Press, 1952), ch. 2.

52. For a historical review of the question in the United States, see G. Gilmore, *Security Interests in Personal Property* (2 vols.) (Boston, Little, Brown, 1965), vol. I, ch. 1-8.

or security leases. Second, nowhere does the statute define “security interest”. Courts are required to divine or define the notion — either by reference to essences, forms, finalities or consequences. Third, as legislation meant to rationalize the law relating to security on personal property, the statute is both overinclusive — embracing in part non-security devices such as long-term leases not intended as security, as well as absolute assignments — and underinclusive — leaving aside numerous consensual devices such as pawnbroking contracts, transfers of claims under insurance and annuity contracts, and subordination agreements, that may be intended as security. Fourth, the act is limited to the regulation of consensual transactions and does not regulate any non-consensual security institutions such as possessory liens, crop liens, deemed trusts and Crown claims, whether created by statute or by common law. Fifth, the PPSA does not extend to security taken on real estate, although it does deal with fixtures, real estate fruits, and crops. Land mortgages, construction liens and like devices are excluded.

The Article 9 project is a remarkable achievement. But it is not without imperfections — at least as viewed from the perspective of a civil law jurist. Three are significant. First, its failure to elaborate a legal concept of “security interest”, its disinterest in specifying a definition for the intellectual notion itself, are puzzling — courts are still required to do the hard conceptual work. Second, its narrow compass (excluding non-consensual security, excluding some other transactions in moveables, and arguably, excluding interests in land) does not strongly recommend it for emulation in any jurisdiction where formal rationality is a significant intellectual attribute of the system. Third, its patchwork character presupposes much about underlying legal regimes that may not always be viable, in particular the attenuation of the distinction between rights in a debtor’s property (security rights), and the contingent withholding of a debtor’s eventual rights (title transactions). These perceived flaws are nicely captured by the different linguistic usages by which common lawyers and civil lawyers tend to define the field: for the former “secured transactions” is canonical; for the latter “security on property” captures the broader sweep of the legal regime.<sup>53</sup>

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53. In addition to these substantive points — which, to be fair, a common law jurist might well consider not as imperfections, but simply as the result of policy decisions about the elaboration of the regime — one might also point to the execrable style of legislative drafting that afflicts not only the PPSA but most common law statutes.

At the end of the day, one wonders whether the need for legislative intervention might be traced, at least in part, to the failure of the common law to maintain specialized commercial courts in parallel to Chancery so as to evolve in the realm of secured transactions in personal property doctrines and principles analogous to those that courts of Equity so effectively developed to turn mortgage transactions into functional hypothecations. Moreover, one wonders exactly what new purchase Article 9 is bringing to the idea of functionalism in secured transactions,<sup>54</sup> and whether its major contribution might lie, rather, in its simplification and rationalization of publicity, priorities and enforcement. To test this proposition, one might look to reform initiatives in civil law countries.

## 2. Civil Law Functionalism

The Romano-Germanic tradition developed the concept of a non-possessory security right — the hypothec — well before Justinian's codification. A hypothecation was conceived as a real right in a debtor's property made liable for the fulfilment of an obligation that enabled the creditor to follow the property upon its disposition, to seize it, to sell it, and to obtain a preference in the price received.<sup>55</sup> Over the next two millennia, this well worked-out conception of a security right permitted courts and legislatures to focus directly on transactional fairness and the protection of third-party interests in the realm of security and to ensure an appropriate instantiation of the concept.

More than this, the definition enabled them either to bring into the realm of security a number of transactions that formally appeared to be something else, or to declare void various contractual undertakings that sought to indirectly generate a security right

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Commentators also note that with successive versions of Article 9, the quality of legislative drafting is also declining, as the article seems increasingly to be oriented to providing detailed solutions to specific issues.

54. The question in issue is whether common law functionalism as developed in Chancery is qualitatively different from statutory functionalism as elaborated in, for example, s. 2 of the PPSA. Presumably the litmus test for answering this question is the conditional sale or lease-purchase of real estate. Is it conceivable that Chancery courts would ultimately have come to the conclusion that the conditional sale should be analogized to a mortgage? On this point see Smith, *supra*, footnote 50. See also, L. Smith, "Relief Against Foreclosure" (2001), 60 *Cambridge L.J.* 178.
55. The most comprehensive comparative discussion of the issue to be addressed in this section is J.-F. Riffard, *Le security interest ou l'approche fonctionnelle et unitaire des sûretés mobilières* (Paris, L.G.D.J., 1997).

that did not meet the formal requirements for such devices. So, for example, the prohibition on non-possessory security in moveable property was read functionally to prevent double conditional sales agreements, and other attempts to reverse the dissociation of possession and title implied by the pledge.<sup>56</sup> Likewise, it justified the attitude of the French *Cour de cassation* in declaring void transfer of title clauses (giving in payment clauses or *clauses de dation en paiement*) inserted into hypothecary agreements and commissary agreements or *pactes commissaires* adjunct to contracts of pledge. Here functional analysis of a clearly articulated concept of security enabled courts to maintain the logic of the pre-established regulatory regime and to defeat mortgage foreclosures.

But not all civil law jurisdictions followed the lead of the *Cour de cassation* in relation to mortgage-type transactions. Building on the logic of the well-known sale with a right of redemption, courts in Quebec and Germany came to accept the legality of other title transactions — the giving in payment clause, the commissary agreement, and agreements permitting non-judicial creditor realisation (the *clause de voies parées*) — in the former, and the fiduciary transfer of title in the latter. In addition, by the late 19th century, acceptance of the principle of consensualism in sale opened the door to various vendor-originated title retention devices that soon were playing a significant role in financing transactions involving moveables.<sup>57</sup>

Of course, these title devices were not without their difficulties, both for debtors (where automatic foreclosure operated to appropriate acquired equity), and for third parties (where in moveable

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56. For discussion of the attitude of courts to these transactions see E.E. Saunders, "Pledge, Commercial Pledge, Sale with a Right of Redemption, and Similar Security Devices" in *Meredith Memorial Lectures: Security in Moveable Property* (Montreal, Wilson and Lafleur, 1967), p. 16.

57. For Quebec, see G. LeDain, "Security on Moveable Property in the Province of Quebec" (1956), 2 McGill L.J. 77. In Quebec mention should also be made of special legislative regimes to facilitate corporate finance, notably "trust deed security" under the Special Corporate Powers Act (first enacted in 1914). For Germany, see U. Drobnig, "Germany" in J.G. Sauveplane, ed. *Security Over Corporeal Movables* (Leiden, Sijthoff, 1974) at p. 181 and U. Drobnig, "A German View" in J. Ziegel and W. Foster, eds., *Aspects of Comparative Commercial Law* (Dobbs Ferry, Oceana, 1969), p. 368. For France, which for a long time rejected the possibility, regulating such sales only with the *Loi Dailly* in the 1990s, see P. Crocq, "Dix ans après, l'évolution récente des propriétés-garanties" in *Rupture, mouvements et continuité du droit* (Paris, Economica, 2004), p. 347.

transactions there was no adequate regime of publicity). Hence, in tandem, courts and legislatures responded by attempting to regulate the exercise of these mechanisms.<sup>58</sup> To date, however, most civil law jurisdictions have not sought to enact comprehensive legislation to regulate both publicity and enforcement.<sup>59</sup> Indeed, Quebec became the first jurisdiction in the civil law world to enact the conceptual equivalent of Article 9 as part of its civil code when the Civil Code of Québec was proclaimed in force in 1994.<sup>60</sup> As noted, in the 1970s, the CCRO proposed, through an idea it characterized as a “presumption of hypothec”, to comprehensively regulate the concept of security.<sup>61</sup> Although the proposal was not carried forward into the Civil Code of Québec, the National Assembly could not simply ignore the problem of title security. So, following the lead that it traced out in the 1930s and 1960s it decided to engraft onto specific regimes of title security a number of procedural mechanisms that would protect a debtor’s equity.

Instead of announcing a general principle to the effect that every attempt to deploy title to secure the performance of an obligation would be subject to a uniform debtor protection regime, the Civil Code of Québec merely identifies paradigmatic transactions to which this regime (or parts of it) applies. In addition, rather than providing that the entire panoply of procedural constraints applicable to hypothecs is also applicable to the designated title transactions, the Code has left various collateral features of title security un- or incompletely regulated. All this to say that the Civil Code of

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58. In Germany, the attempts were largely ineffectual and even today title retention security does not require publicity. See, for discussion, U. Drobniç, “Le projet de guide législatif face à la propriété-sûreté: un casus belli” in *L’apport du Guide législatif de la CNUDCI à la réforme du droit des sûretés*, *supra*, footnote 48, at p. 46. Quebec took a different route, four times legislatively choosing to create a procedural device — in 1947 (article 1561*a* to 1561*j*) and 1972 (the Consumer Protection Act) a registration regime to protect the buyer of moveables, and in 1938 (articles 1535*a* to 1535*d*) and 1963 (articles 1040*a* to 1040*e*) a 60-day notice requirement to protect a debtor’s “equity of redemption” in immovable transactions — in respect of these title transactions.
59. On this history see J.E.C. Brierley *et al.*, *Quebec Civil Law* (Toronto, Emond-Montgomery, 1993), pp. 714-16.
60. Of course, some would argue that when Louisiana adopted Article 9 in 1990 as part of its commercial code it became the first civil law jurisdiction to modernize its secured transactions in this manner. See <<http://www.sos.louisiana.gov/comm/ucc/ucc-revised-article-9-changes.htm>>.
61. For an historical analysis of attempts to bring title transactions under the rubric of security devices in Quebec see Macdonald, “Faut-il s’assurer d’appeler un chat un chat?” *supra*, footnote 12.

Québec regulates title transactions in a highly variegated and not patently coherent way: sometimes by reference to one or more features of the hypothecary regime (*e.g.*, instalment sales, sales of immovables under resolutive condition, sales with a right of redemption, security trusts); sometimes only by regulating publicity (*e.g.*, finance leases); sometimes through an outright prohibition (*e.g.*, giving-in-payment clauses); and most often it simply leaves the particular transaction unregulated as a security device.<sup>62</sup>

By contrast, in the other modernized secured transactions regime — that found in Ukraine — the generic category is defined broadly as a charge: traditional security devices in a debtor's assets are characterized as secured charges; other consensual limitations on an owner's rights are characterized as “contractual charges”, and non-consensual limitations are characterized as “public charges”.<sup>63</sup> In the manner of Article 9, a number of formalities relating to capacity, creation, scope, publicity, priorities and enforcement are imposed on various existing codal institutions, which themselves are not directly modified. These formalities roughly track those of ordinary security, although to acknowledge the specificity of conditional ownership, the regime differentiates certain rights and recourses according to the character of the transaction in question — that is, according to where title is located at any particular moment in the transaction.

In other words, both Quebec and Ukraine regimes illustrate how legislatures can at the same time acknowledge functionalism, yet discipline functional arguments by constraining them within an *ex ante* conceptual frame. That is, the two regimes acknowledge the conceptual difference between title devices and security devices by conceptually grouping all manner of title transactions (instalment sale, sale under resolutive condition, sale with a right of redemption, giving in payment clause) together on the one hand, and conceptually grouping all manner of security devices (pledges, rights of retention, hypothecs) together on the other.<sup>64</sup> The Charge

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62. On the details of this approach see Macdonald and Ménard, “Credo, credere, credidi, creditum: Essai de phénoménologie des sûretés réelles” *supra*, footnote 48.

63. For the definition of a charge, and a detailed review of its different instantiations, see R.A. Macdonald, *Commentaries*, *supra*, footnote 19, at pp. 106-55.

64. An alternative strategy for regulating various title transactions that tracks the general approach taken by the common law to real estate transactions has been adopted by UNCITRAL in its legislative guide proposals. Rather than distinguish between legal devices on the basis of their functional character — as title-based or as patrimonial preferences — as in Quebec and Ukraine, the guide distinguishes according to the

Law in Ukraine has the additional merit of tracing out the specific consequences of functionalism within the concept of ownership in a comprehensive manner, rather than leaving much of the detail unregulated, as in Quebec.

### 3. Functional Functionalism

This review of the uneasy marriage between functionalism and formalism in the characterization of transactions intended, or operating, as security suggests three lessons. All are applicable equally to common law and civil law regimes.

One is this. There is a significant difference between the ways in which legal concepts can be reformed or recast depending on the field of law in issue. In general, it is much easier for legislatures and courts to extend concepts through analogy, fiction and appeals to functionalism when concepts are shared as between markets and the law. This is in large measure because economic transactions are grounded in an instrumental logic, and with the signal exception of the idea of ownership itself, they tend not to carry enormous symbolic freight.<sup>65</sup>

In addition, however much legislatures seek to build regulatory regimes by deploying concepts that are defined by their “essential” features, the exercise of characterisation will always lead to asking what exactly a particular factual situation is. To say that the essential feature of a hypothec is that it is a right of a creditor in the property of a debtor meant to secure the performance on an obligation, implies that any contractual attempt to create or reserve such a right — no matter how described legally by the parties — will be a hypothec. No legal concept, unless consecrated by a specific exclusionary form, can ever have its frontiers determined without reference to its *telos* or purposes.<sup>66</sup>

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character of the creditor. Hence, “title-transfer devices” such as sales with a right of redemption, sale-leaseback, double-sales, fiduciary transfers of title, giving in payment clauses (*pacta commissaria*) and the common law mortgage are treated as “true security”, whereas “title-retention devices” such as instalment sales, hire-purchase agreements, leases and consignments are imagined as possibly subject to regulation in a regime that acknowledges the creditor’s title as the source of its rights. See UNCITRAL, Working Group VI — Secured Transactions (acquisition financing devices), *supra*, footnote 22.

65. On this point see Macdonald, “Triangulating Social Law Reform”, *supra*, footnote 5, where a contrast is drawn between functional regulation of security interests and attempts to define the concept of marriage in functional terms.

66. See, in particular, Macdonald and Kong, “Patchwork Law Reform”, *supra*, footnote 33.

Third, when legislatures attempt to deploy purely functional definitions to legal phenomena, they wind up having to recreate formal distinctions within the boundaries of the new functional concept. Collapsing the distinction between owing and owning, between true security and title deployed to secure the performance of an obligation, does not relieve a legislature of the need to determine whether, in a competition between secured creditors, a distinction should be drawn between a creditor who was once an owner (a vendor) and a creditor who is merely a financier (a lender). Indeed, the priority afforded to the vendor's hypothec (or a "purchase money security interest") merely replicates the logic of an instalment sale or a sale under a resolutive condition in regimes that continue to distinguish between security and title devices.<sup>67</sup>

Whatever the particular field of law, essentialized concepts find their frontiers in the language of functionality, and functional concepts will still have to be decomposed for certain purposes by reference to the "essences" of the discrete transactions that are deployed to achieve a supposedly identical function. So, for example, to determine whether a particular transaction is a PMSI also requires deciding whether it is a sale or sale-variant, or whether it is a lease. The salient difference between Article 9/PPSA approaches in the common law and the conceptual approaches of civil law Quebec and Ukraine to regulation of secured transactions law ultimately reduces to where the default logic is placed: formalism as allocated on functional grounds (the approach of the Civil Code of Québec and the Charge Law in Ukraine), or functionalism as disaggregated on formalist grounds (the approach of Article 9, the Canadian PPSAs and the common law mortgage).

#### 4. *De Lege Ferenda* — Ukraine

The Charge Law has now been in force for almost two years (since January 1, 2004), and the registry has been open for just over a year (since September 1, 2004). Has the reform been a success? If measured by the number of registrations, the interest in the law and its apparent utility in organizing priorities and realizations, the answer is a resounding yes. Of course, there are always technical glitches, gaps and other minor corrections to be made. But apart from these perfunctory amendments what else remains to be done?

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67. See Bridge *et al.*, "Formalism, Functionalism", *supra*, footnote 28.

From a contemporary vantage point, one can identify three areas where substantial improvements to the law could be made in its next iteration.<sup>68</sup>

First of all, the law remains a stand-alone statute that purports to regulate only certain aspects of security on moveable property in Ukraine. It does not directly modify either the existing Pledge Law or the Civil Code. Moreover the latter two enactments themselves are largely duplicative and not always consistent as between themselves. While the Charge Law is expressly stated to prevail in cases of conflicts between these three pieces of legislation, one hopes that in the first set of general amendments to the Civil Code of Ukraine, it can be fully integrated into this basic law, with the Pledge Law being repealed in consequence.

Second, for reasons already elaborated, the Charge Law is a first-generation secured transactions law. As a result, its principal targets are basic business and consumer property — corporeal moveables such as equipment, inventory and accounts receivable on the one hand, and consumer durables on the other. As experience with the law accumulates one might imagine that it will undergo an evolution similar to that of Article 9, and rules relating to deposit accounts, intellectual property, letters of credit and other specific transactions will be inserted into its general framework.

Third, while rudimentary attempts have been made to specify how the regime is meant to interact with contiguous areas of legal regulation — most notably, securities, negotiable instruments, conflicts of law and insolvency — it is nonetheless fraught with a number of regulatory gaps and incompletely specified principles. These will have to be more carefully elaborated in subsequent versions of the law.

In addition to these general improvements, it would probably be expedient, as lawyers, registrars and judges become more familiar with the new regime, to gradually replace the *ex ante* regulation of creditor recourses with a structure that gives greater scope for party autonomy, subject to *ex post facto* judicial review on a standard of good faith and commercial reasonableness.

All this said, however, the Charge Law appears to be a relatively successful enactment that has produced a modernized and rationalized

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68. The observations of the next four paragraphs result from conversations with Mr. Yaroslav Gregirchak, currently practicing in Kiev with Chadbourne Parke LLP, who was one of the two Ukrainian lawyers responsible for drafting the Charge Law.

law of security on moveable property well adapted to the social, economic, political and legal environment into which it has been projected.

### 5. *De Lege Ferenda* — Quebec

Book Six of the Civil Code of Québec has now been in force for almost a dozen years. During that period a number of cases have come before the Supreme Court of Canada. In some of these, the Code has been found wanting; in others, it is the court that seems to have been unable to meet the challenge.<sup>69</sup> Of course, there are numerous little errors or misstatements, typically implying no great policy debate, which could be easily fixed.<sup>70</sup> Nonetheless, it would seem that the most glaring deficiencies can be located in four main areas.

First of all, the problem of title security remains poorly worked out. The Civil Code of Québec does not announce a general principle respecting publicity and realization for all title security. Rather, it merely specifies certain transactions to which the regime (or parts of it) applies, and thereby invites parties to seek to create transactions falling just outside the scope of the regulated type.<sup>71</sup> It is not difficult to see how different the outcome would be were the National Assembly (or the courts interpreting the Civil Code of

69. See notably *Caisse populaire Desjardins de Val-Brillant v. Blouin*, [2003] 1 S.C.R. 666, 225 D.L.R. (4th) 577 (determining the scope of the prohibition of article 2683); *Lefebvre (Trustee of) (Re)*, [2004] 3 S.C.R. 326, 244 D.L.R. (4th) 513; *Ouellet (Trustee of) (Re)*, [2004] 3 S.C.R. 348, 244 D.L.R. (4th) 532 (determining the scope of the registration requirement of article 1852).

70. Among the more notable are: article 2669 (currently providing that upon the expiration of a usufruct a hypothec granted upon the bare ownership does not extend to the usufruct); article 2790 (currently providing that sales by a creditor do not extinguish lower-ranking hypothecs); article 2762 (currently providing that law costs covered by a hypothec do not embrace non-tariffed items); article 2695 (currently providing that a hypothec on rentals produced by an immovable is registrable in the land register, but an outright assignment of these rentals is registrable in the moveable register); article 2754 (currently restricting the super-priority to vendors and excluding purchase-finance lenders); article 2674 (currently restricting tracing into cash proceeds of ordinary course dispositions to situations where no tangible property replaces hypothecated assets). On these various technical deficiencies with the regime see Roderick A. Macdonald, *Memorandum on Desirable Changes to Book Six of the Civil Code of Québec* (unpublished, 2003).

71. A similar course was pursued with articles 1040a to 1040e of the Civil Code of Lower Canada, and it was only with the decision of a nine-member bench of the Quebec Court of Appeal in *Nadeau v. Nadeau*, [1977] C.A. 234, that Quebec courts began to read these provisions as stating an unlimited general principle.

Québec) to have presented the four regulated transactions as illustrative models, and to have provided that any other title transaction that functionally operates like one of those models would be subject to the same governing framework. Had it done so, it would have illustrated how legislatures can both acknowledge functionalism, yet discipline functional arguments by constraining them within an *ex ante* conceptual frame that respects the specificity of ownership.<sup>72</sup>

In addition, rather than providing that the entire panoply of procedural constraints applicable to hypothecs is also applicable to the designated title transactions, it left significant elements of the title security regime unregulated. So, for example, restrictions set out in articles 2683 and 2684 on the categories of debtors who can grant certain types of hypothecs are not extended to sales under resolutive condition, instalment sales, or sales with a right of redemption. The consequence of this neglect is obvious; parties prohibited from hypothecating will invariably opt for title transactions simply to get around the prohibition. How different the outcome would be were the Civil Code of Québec to have made the substantive regime of hypothecs (including limitations on capacity, formalities for constitution of the security, and rules governing publicity) applicable to all title transactions deployed as security.

Secondly, there is a major unresolved problem concerning the capacity of persons not carrying on an enterprise to grant non-dispossessory security over moveable property or to grant hypothecs over a universality of property. Even though article 2683 was modified in 1998 to permit non-dispossessory hypothecation of road vehicles and other objects determined by regulation (of which none have been designated) the article still is vastly over-inclusive. If consumers can purchase all manner of property on instalment sale, why are they prohibited from granting a non-dispossessory vendor's hypothec?<sup>73</sup> Moreover, the article makes no distinction as

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72. For example, even though sales under suspensive condition produce almost identical consequences to instalment sales, the former are currently unregulated while the latter are closely assimilated to a security device by articles 1745 to 1749 for purposes of registration, enforcement upon default by the purchaser and priorities. For a suggestion as to how the legislature could have proceeded (and the courts could still proceed) and an elaboration of how this approach would work in practice, see Macdonald and Ménard, "Credo, credere, credidi, creditum: Essai de phénoménologie des sûretés réelles", *supra*, footnote 48.

73. For example, article 2683 prohibits a natural person who does not carry on an enterprise from granting a hypothec without dispossession over moveable property; only the pledge is available as a security device. Nonetheless, this same debtor could pur-

to the kinds of property in issue. Thus, an entrepreneur who seeks to hypothecate deposit certificates and like securities may not do so since the portfolio would not normally be an asset of the enterprise. Precisely this limitation caused the Supreme Court in the *Val Brillant* case to rewrite the law of possession of instruments in Quebec in order to characterize non-negotiable deposit certificates as corporeal property subject to dispossessory hypothecation (pledge).<sup>74</sup> As for the rule in article 2684 — which prohibits natural persons not carrying on a enterprise from granting hypothecs over a universality of property — one is again confronted with an over-inclusive prohibition that prevents entrepreneurs or professionals from, say, hypothecating their stock portfolio as a universality, or granting a hypothec over a universality of assets such as an art collection.

Third, these two prohibitions illustrate that the Code was not conceived with modern commercial practices in mind. Its regulation of hypothecs on share certificates, securities, negotiable instruments, incorporeal business assets, intellectual property, debentures, partnership shares, investment and mutual funds and like assets is rudimentary.<sup>75</sup> One observation will illustrate the point. The Civil Code of Québec contains no special priority rule like that found in Article 9 and the PPSAS to privilege “publicity by possession” over “publicity by registration” in respect of negotiable securities. In the next iteration of the Code, substantial attention will have to be devoted to enacting rules that are more attuned to the needs of modern commerce.

Fourth, the enforcement regime is heavily laden with *ex ante* controls that reflect the kinds of considerations that might properly come into play in relation to security upon immoveable property, but that have less place in a regime of security on moveables. One might hope either that the regime of an advance 20-day (or in the case of consumer transactions 30-day) prior notice as elaborated by article 2758 of an intention to exercise a hypothecary recourse against moveable property might be shortened to something like 72 hours, or that it be dispensed with altogether where the debtor is

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chase moveable property (say, a sailboat) under an instalment sale — a transaction that actually vests greater enforcement rights in the seller.

74. *Val-Brillant*, *supra*, footnote 69.

75. On these points, see generally, Payette, *Les sûretés réelles dans le code civil du Québec*, *supra*, footnote 15, at pp. 412-605.

carrying on an enterprise. Were this to be the case, the notice would be required only after a creditor takes possession and, as in PPSA regimes, its purpose would be primarily to inform the debtor and third parties of the specific realization recourse that the creditor intends to pursue.

Let me conclude this review of the shortcomings of the Civil Code of Québec on a positive note. Book VI on Prior Claims and Hypothecs was the first comprehensive enactment that reformed the law of security on property in a civil law jurisdiction. Without the benefit of any other model, the National Assembly was able to achieve both modernization and rationalization in a manner that embraced moveable and immoveable property, consensual and non-consensual security, execution preferences and traditional security devices, and at the same time regulated the major title transactions that are deployed to secure the performance of obligations. It is a model that has inspired other civil law jurisdictions, and that reveals how it is possible to achieve the benefits of functionalism in the regulation of security devices without at the same time obliterating the distinction between owning and owing. This, it seems to me, is a remarkable accomplishment.

#### IV. CONCLUSION

The patterns for modernizing secured transactions law in North America — in the United States under Article 9, in common law Canada under the PPSAs, in Quebec under Book Six of the Civil Code of Québec — presuppose an endogenous exercise of legal analysis that takes the basic assumptions of existing private law and legal institutions as the soil within which the reforming endeavour will be rooted. But not all secured transactions reform is of this character, as the pattern of modernization in the former socialist republics of central Europe illustrates. There, the felt imperative to reform has not led to reflection about the background conditions necessary for successful implementation of reform measures but rather to a continuing series of exogenous transplants.<sup>76</sup>

76. See generally the essays cited *supra*, footnotes 21, 31 and 32. Of course, this is not to say that reflection about the conditions necessary for successful implementation is unnecessary where law reform is fundamentally endogenous. Rather, the point is that general agreement about and familiarity with context tends to reduce political debate to matters of technique. See R. Scott, "The Politics of Article 9" (1994), 80 Va. L. Rev. 1783 and, more generally, all the articles in the "Symposium on the Revision of Article 9 of the Uniform Commercial Code" (1994), 80 Va. L. Rev. at pp. 1783-2311.

The relative importance of endogenous and exogenous factors in Quebec and Ukraine offer an interesting contrast. In the 1980s, even though attempts to transplant the overall approach of Article 9 into Quebec ultimately ran up against political resistance grounded, it has been argued, primarily in rent-seeking and ill-considered legal atavisms, for the most part the level of sophistication in the profession enabled the legislature to achieve workable modernizing compromises that respected both the efficiency imperative and the logic of existing law as a semi-independent variable. Not so for transplanted Article 9 regimes in civil law Europe in the 1990s. To begin, local resistance from entrenched interests such as the emerging indigenous legal profession was generally not strong enough to produce rejection of transplanted regimes that appeared, at least at first blush, to be workable in practice. Moreover, the externally induced drive to modernize institutions of commercial law (largely driven by transnational organizations like the World Bank and the EBRD that placed great stock in models offered by economists in their employ) generated an approach to commercial law reform that treated law as a dependent variable, easily malleable under the relentless hammer of economic analysis. Soon enough, the transplanted regimes create confusion and incoherence elsewhere in the legal system and have to be restructured in consequence.<sup>77</sup>

This article has argued that a broad panoply of factors besides the general structure of the legal regime comprise the overall context of commercial law reform. For this reason, it is important to be clear about the various economic, social and political conditions that are presupposed by existing regimes of secured lending so that the policy goals sought to be achieved through these principles can be realized in practice.<sup>78</sup>

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77. Of course, the experience of each state is slightly different. In Ukraine, resistance to the proposed transplant was immediate, and resulted in a pre-enactment recasting of the modernizing legislation. In Serbia and Slovakia resistance was more muted, although it was reflected in attenuations to the Article 9 model, and in subsequent adjustments to the law. In Romania it was too weak to prevent enactment of an Article 9 statute, but is now manifest in the simple non-utilization of large parts of the law as enacted.

78. It follows that the plea here is against both the formalist “transplants are unproblematic” accounts of law reform, and the hyper-sceptical “no transplant is possible” accounts of legal change. See generally, D. Nelken, “Towards a Sociology of Legal Adaptation” in D. Nelken and J. Feest, *Adapting Legal Cultures*, *supra*, footnote 4, at p. 7. For a particularly Canadian take on this issue, see H.W. Arthurs, “Cultures and

I conclude by repeating in slightly modified form the four central lessons learned from attempts at modernization of commercial law regimes as set out in the introduction. First, in conceiving the architecture of reform, legislatures must avoid sacrificing the policy goals to be achieved to a particular set of legal techniques deployed elsewhere to achieve these goals. Second, secured transactions legislation is neither fungible from jurisdiction to jurisdiction nor a free-standing segment of legal life that can be deduced in the abstract from economic models; because law is not a semi-independent variable, successful reform must attend both to the legal infrastructure of particular states as well as to political and social “facts on the ground”. Third, the effectiveness of legal reforms is not automatic; both prior to and after enactment steps to acculturate legal and economic actors must be taken in order to ensure that the objectives of the reform are realized in practice. Fourth, the simplistic *formulae* of macro-comparative law that associate reified dichotomies like formalism and functionalism with the civil law and the common law respectively, impede analysis of the conditions under which reform of secured transactions law can be successful.

To these four lessons I should like to add a fifth. The headlong rush to export western European concepts of legality under the guise of (in public law domains) the Rule of Law, and (in private and commercial law domains) economic efficiency has revealed two large gaps in policy and process. The first of these is the gap between theory and practice: between the ambitious modernizing programmes promoted by the IMF, World Bank, NGOs and assorted do-gooders who think that they will lead to unproblematic economic prosperity and the facts on the ground.<sup>79</sup> The second, and more insidious because less visible, is the gap between the stated goals of individual programmes sponsored by these organizations, and the actual activities that are being funded. To be candid, we do not really know what modernization programmes are actually working, and we do not know why individual programmes succeed or fail. More troubling, we do not really know what it means for a law reform project to succeed or fail. Most serious of all, we do not even really

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Legal Systems: A Canadian Perspective” in R. Blanpain, ed., *Law in Motion* (The Hague, Kluwer International, 1997), p. 49.

79. On these points see E. Jensen and T. Heller, eds., *Beyond Common Knowledge: Empirical Approaches to the Rule of Law* (Stanford, Stanford University Press, 2003).

know how to design empirical studies of these issues, to frame questions and hypotheses that can be tested, and to carry out the detailed field research entailed by these hypotheses.<sup>80</sup>

Finally, we need to locate our evaluations of commercial law reform within a better understanding of how local entrepreneurial networks and credit institutions function on the ground. The claim to universalism in accounts of modernization must be given up in favour of more differentiated analyses and prescriptions for particular times and for particular places. The boosterism of Article 9 norm entrepreneurs needs to be tempered by a realistic assessment of what can actually be accomplished in transnational commercial law reform.<sup>81</sup> If I have made even the slightest contribution in this essay to raising these issues, I shall be content.

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80. On these questions see J. Esser, "Evaluating Dispute Resolution — We Don't Know What We Think and We Don't Think What We Know" (1989), 66 *Den. U. L. Rev.* 660.

81. To put the matter slightly differently, most commercial law reform takes its cue from a metaphysical philosophical approach of the type reflected — in instantiating principles of justice to which presumably regimes of secured transactions are directed — in works like J. Rawls, *A Theory of Justice* (Harvard, Bellknop, 1971) and R. Nozick, *Anarchy, State, Utopia* (New York, Basic Books, 1974). My experiences with commercial law reform in Quebec, in Ukraine, in Vietnam and with UNCITRAL's Working Group VI suggests that differentiated models of distributive justice of the type suggested by M. Walzer, *Spheres of Justice* (New York, Basic Books, 1985) and Jon Elster, *Local Justice* (New York, Russell Sage Foundation, 1992) are more likely to direct Article 9 norm entrepreneurs to successful international law reform.