Publicity in secured transactions law: Towards a European public notice filing system for non-possessory security rights in movable assets?

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Chapter 2

Introduction to the puzzling concepts of publicity and possession

secured lenders

the debtor

secured lenders

the debtor

purchase money lenders

stated value

buyers in the ordinary course

stated value

attaching unsecured creditors

stated value
1. Introduction

As already indicated in the previous chapter, an important motive behind the universal call for public filing is the desire to do justice to the principle of publicity. Although in legal literature on property law and related subjects only few in-depth analyses are devoted to this subject, in both civil and common-law tradition the principle of publicity is regarded as a fundamental principle of property law and accordingly of secured transactions law. In a nutshell, it is based on the idea that property rights (should) only have effect vis-à-vis third parties if they are actually public, i.e. can be known by such third parties:

"Because property rights affect third parties, natural justice requires that such rights should only arise in circumstances where they are apparent to third parties. In other words, property rights should be public."

The universal call for public filing of non-possessory security must be seen in the context of the fact that the publicity notion is also applied to security rights. The means to make security rights public is traditionally sought in the transfer of possessory security to the secured lender. In the 19th century various European legislators made an explicit choice in favor of the principle of publicity, by only permitting forms of possessory security in their Civil Codes. The introduction of non-possessory security rights

1 See Chapter 1, subsection A.4.
2 The term 'publicity' is mostly used by civil lawyers. Outside civil law countries, references to terms such as '(public) notice' are made more often. Cf. Kozolchyk & Furnish 2003, p. 10. I found two exceptions to the rule in Dunham 1949, p. 610 and LoPucki, Abraham & Delahaye 2013, p. 1798 who speak of 'publicity' despite their U.S. roots.
3 Two in depth-analyses worth mentioning are: Zhang 2004 and Borkhardt 2007.
5 Benjamin 2000, pp. 105-106. Cf. 'Discussion Paper on Moveable Transactions (no. 151)' (Edinburgh: The Scottish law Commission, 2011), p. xxiv, in which the principle of publicity is defined as follows: "The principle that what affects third parties should be discoverable by third parties." On p. 93, it is added: "The traditional requirement for third-party effect is that there be some external (overt) act in addition to the private agreement. That idea goes by the name of the publicity principle." (footnotes omitted). See furthermore 'Secured Transactions Systems and Collateral Registries' (Washington DC: IFC, 2010), p. 19 describing publicity as "the means of making a claim against movable property transparent to third parties", Dalhuisen II 2013, p. 465 and supra footnote 61 of Chapter 1.
6 Among many others, see Kieninger 2004, p. 655.
7 See on this matter e.g. Jansen 1999, Sagaert 2009, p. 25, Salomons 1994, p. 1261 and Steven 2008, p. 15-44. At the same time, in many European jurisdictions systems of publicity were established for immovable property, with mandatory filing of deeds in the public registers.
1. Introduction

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security throughout Europe, a century later, received much criticism because of its ‘silent’ or ‘non-disclosed’ nature:

“Secured transactions law has always recognized the possessory pledge and it is traditionally explained that possession of the collateral by the pledgee provides ‘publicity’.”8

Similar concerns were expressed in relation to the recognition of the ‘silent’ delivery constito possessorio (‘delivery c.p.’) to transfer ownership of an asset. This (constructive) form of delivery was also associated with the principle of publicity, or to put it more accurately, with a violation of that principle:

“The publicity principle is a policy, and the actual law does not always adhere to it. For example, the ownership of goods can pass in a sale by simple agreement, so that the law confers on a contract external effect.”9

The opposition to non-possessoriy security is widespread: it is not only reflected in Western European literature,10 but also in various Eastern-European, Asian, U.S.11 and South-American model laws on public filing. Nonetheless, little attention is paid to the question how ‘publicity’ or ‘making public’ should be understood, or better put: how physical possession – or transferring physical possession when creating a possessory charge – may (have) assist(ed) attempts to ‘make public’ security rights. In this chapter, I will analyze the various arguments that are often put forward to justify the enhancement of publicity in several legal systems. In doing so, I aim to

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8 Sigman 2008, p. 148. Cf. Asser/Mijnssen, Van Mierlo & Van Velten 3-III 2010/147 (translated): This requirement [of placing the object within the power of the secured lender, DJYH] is a consequence of the principle of publicity. The act can be compared to the delivery of a movable tangible, which is completed by physical transfer of possession. Physical transfer of possession is performed by conferring to the transferee the power that the transferor was able to exercise over the tangible.” See also infra footnote 24 of this Chapter.
9 ‘Discussion Paper on Moveable Transactions (no. 151)’ (Edinburgh: The Scottish law Commission, 2011), p. 93-94, on Scots law. Cf. Zwalve on this matter: “The question whether a legal system still draws upon publicity as a fundamental principle with respect to the transfer of movable tangibles has always been related to the question whether the legal system has remained faithful to the Roman tradition (loyal to the demand of providing possession or ‘traditio’), or has allowed consensus of parties to be decisive.” Zwalve 2006, p. 240 et seq. (translated). Cf. Peter: “One of the principles of our property law is that proprietary relationships must be public to third parties. From this so-called principle of publicity it follows that a proprietary transaction is only effectuated if it is evident to the outside world. The delivery requirement can therefore be regarded as a consequence of this principle of publicity.” Peter 2007, p. 4 (translated). See on Dutch law also Salomons 1994, p. 1264-1266, which translates as follows: “The principle of publicity was amply satisfied in the Dutch Civil Code of 1838, because it, unlike the Consensual Code Civil, respected the tradition system: transfer requires delivery.”
10 See e.g. Dirix 2004, p. 83. For this branch of criticism in Dutch law, see mainly Meijers 1936, p. 237-284.
11 See e.g. Livingston 2007, p. 115: “Courts had an instinctive abhorrence for those so-called secret liens privately created security interests in favor of a particular lender that were hidden from view because the debtor retained possession of the encumbered property.”
clarify many ambiguities that obfuscate the publicity issue, in particular with respect to the link between ‘possession’ and ‘publicity’.\textsuperscript{12}

2. Two approaches to justify the need for publicity

I already noted that in legal literature on property law, only few in-depth analyses are devoted to the publicity subject. In fact, most legal scholars make only brief reference to the general notion that property rights have third party effect and should therefore be public. Closer analysis makes clear that, within these brief references, two different lines of reasoning present themselves to justify the importance of public information regarding security rights on movable assets.

On the one hand, the need for public information is based on the presumed existence in practice of a \textit{problem}, often referred to as ‘the false appearance of creditworthiness’, ‘the false appearance of wealth’, or ‘the false appearance of ownership’.\textsuperscript{13} In U.S. literature, this problem is often referred to as the problem of ‘ostensible ownership’, a doctrine that finds its roots in \textit{Clow vs. Woods},\textsuperscript{14} often summarized as follows:

\begin{quote}
"Clow thus articulated what came to be known as the problem of ostensible ownership - the making of credit or other investment decisions in reliance on the potentially misleading appearance that a debtor has rights in property by virtue of physical possession."
\end{quote}

\textsuperscript{12} This chapter draws upon an article that has been published in \textit{European Property Law Journal} (2012) 1(2), p. 299-316 and in Dutch, in the Dutch journal \textit{Weekblad voor Privaterecht, Notariaat en Registreer}, 142(6874), p. 133–140.

\textsuperscript{13} See e.g. Dirix: “The requirement of ‘dépossession’ is explained with reference to the need to dispel the false impression of wealth if the pledgor would remain in control of the assets.” Dirix 2004, p. 83. Cf. Mooney 1988, p. 725 and LoPucki, Abraham & Delahaye 2013, p. 1788.

\textsuperscript{14} \textit{Clow vs. Woods}, 5 Serg. & Rawle 275 (Pa. 1819). As far as the transfer of \textit{ownership} is concerned, the problem of ‘ostensible ownership’ finds its roots in the \textit{Twyne’s case}, 3 Coke 80b, 76 Eng. Rep. 809 (Star Chamber 1601). Cf. LoPucki, Abraham & Delahaye 2013, p. 1788, footnote 18.

\textsuperscript{15} Lipson 2004, p. 431. In \textit{Clow vs. Woods}, Judge Gibson ruled e.g. “Would it be less against sound policy to suffer a vendor to remain in possession, under an agreement to that effect expressed in the conveyance, and thus to create a secret incumbrance on his personal property, when to the world he appears to be the absolute owner, and gains credit as such?” Cf. Simkovic 2009, p. 256. See on the ostensible ownership problem also Picker 2009, p. 24-25: “If a debtor transferred a security interest yet kept in possession, possession and ownership were separated. If these “secret liens” were valid, it was no longer prudent to infer ownership from possession. An “ostensible ownership” problem would arise: the debtor would appear to own property, but, in truth, a third party would have an interest in it. The concern that the ostensible ownership problem would lead to widespread fraud led to a simple, bright-line rule: a valid security interest could be created only by transferring possession of the property. No separation of ownership and possession was allowed” and Mooney 1988, p. 725-726: “Proponents of a filing requirement for leases consistently have relied on the doctrine of ostensible ownership as the principle policy justification for such a rule. When a lessor puts a lessee in possession of goods, the argument goes, the lessee’s possession creates the appearance of ownership by the lessee and may mislead third party creditors and purchasers, including secured creditors. Therefore, the lessor should be required to cure this ostensible ownership problem by giving notice (i.e. filing) of its otherwise secret interest at the time of having its interest subordinated to a third party upon failure to file”, Harris 1986, p. 192: “Public notice arguably would ameliorate both aspects of the non-possessory lien problem. It would solve the problem of ostensible ownership because the debtor’s creditors easily could discover incumbrances on goods in the debtor’s possession (...)” and Merrill & Smith 2007a, p. 834.
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Hence, in this first line of reasoning (let us refer to it as the ‘problem solving’ approach), possession in the hands of someone who does not have any rights in the assets as suggested by its possession is said to cause the problem, whereas publicity would have prevented this problem.

The second line of reasoning to justify the need for public information as presented in legal literature takes as its point of departure that third parties have a duty to respect property rights (including security rights) and should therefore be able to be aware of their existence. Hence, in this approach problems of ‘false appearance of wealth’ and the like are not considered. Instead, one abstracts from the practical problem by reasoning from the property law dogma that property rights have third party effect, whereas personal rights do not:

“Da die dinglichen Rechte als absolute Rechte gegenüber jedermann wirken und von jedem Dritten zu respektieren seien, müssen sie auch für jedermann erkennbar sein.”

In short, in this approach (let us refer to it as the ‘dogmatic’ approach) the reasoning seems to be that, because third parties are expected to respect proprietary rights, i.e. are bound by these rights, they must at least know what or which rights they should respect, i.e. what they are bound by. Van Erp in this sense:

“Real rights must be known to third parties, otherwise no justification exists for their binding nature vis-à-vis these third parties. To put it differently, transparency is required: it must be clear upon which object a real right will rest and both object and real right must be visible to the outside world.”

3. The traditional means to make public: (the transfer of) possession

When scrutinizing legal literature on publicity and related subjects more closely, both approaches seem to advocate the enhancement of publicity, whether or not in

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16 See e.g. Van Erp 2009a, p. 28.
17 Translated: “Because property rights as absolute rights have effect against everyone and must be respected by all third parties, it must also be possible for everyone to know them,” Zhang 2004, p. 17.
18 E.g. Van Erp 2009a, p. 16: “The essence of a real right is that a holder of such a right is entitled to respect from third parties (...).”
19 Van Erp 2009a, p. 16. Furthermore, on p. 10 of this article Van Erp argues that predictability is a major aspect of property law. Cf. Van Erp 2009b, p. 1527: “If third parties are to be bound by a right the creation of which happened without their consent, they must at least be able to gather information on such a right (requirement of publicity)”, Merrill & Smith 2007b, p. 1852: “[Property rights] (...) are in rem rights imposing duties of abstention on all other members of the relevant community (...)” and Dalhuisen II 2013, p. 465: “In fact, for proprietary rights of any sort to emerge and be recognized in their third-party effect, some outward sign of them may be desirable to warn and protect the public as it must accept and respect these rights and could only acquire the assets subject to them.”
the form of a public filing system. Furthermore, both approaches have their roots in reasoning that attributes a key role to possession or the transfer of possession:

“(…) possession satisfies the publicity principle of property law.”

In the ‘problem solving’ approach, the requirement of transferring possession to the secured lender is frequently justified by the following argument:

“(…) as a result of the non-possessory pledge, the possibility arises that third parties can be deceived by a false appearance, (…) because now the outsider cannot see that the movable tangibles that he [the debtor, DJYH] has in his possession are encumbered with a security right, so that a false appearance of creditworthiness arises.”

According to the ‘dogmatic approach’, the explanation for the requirement of transferring possession to the secured lender is often one along the following lines:

“(…) as regards most categories of movable property the law has to make use of possession as a means of publication.”

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20 I remind the reader that when I use the term ‘possession’, I am referring solely to the factual situation in which a person has physical control over a movable asset, without intending to define such physical control in any legal sense. In Dutch law, for example, ‘possession’ tends to be used as the translation for ‘bezit’, which is a legal term that connotes a situation in which a person holds a movable asset for itself. This is to be distinguished from the situation in which a person holds the asset for another, which in Dutch may be best translated by the neutral term ‘holder’ or ‘holdership’ (houder or houderschap). In European literature the latter situation is also sometimes referred to as ‘detention’. When I use the term ‘non-possessory security’, I am referring to the situation in which the debtor has given a security right to its lender, while at the same time remaining in possession – i.e. in physical control – of the assets. See supra Chapter 1, footnote 8.

21 Steven 2008, p. 12. Cf. Cashin Ritaine 2012, p. 17: “(…) the universal effect of proprietary rights is subject to compliance with prescribed methods of publicity, based mainly in possession and registration (…)”. In footnote 91 she adds to this: “Especially for real rights in immovables, but also for certain rights (especially security rights) in movables (…)”. Cf. ‘Secured Transactions Systems and Collateral Registries’ (Washington DC: IFC, 2010), p. 19: “Publicity: the means of making a claim against movable property transparent to third parties, commonly provided by registration in a public registry, by taking possession or control of the movable property, by direct notice, or by other means?”, Merrill & Smith 2007a, p. 832: “In earlier times, when registries were nonexistent and commerce was simpler, possession was usually taken as the best evidence of property rights” and Sagaert 2005, p. 989.

22 Pitlo/Brahn, Groot & Breemhaar 1980, p. 474 (translated). For U.S. law, see Transp. Equip. Co. v. Guaranty State Bank, 518 F.2d 377, 381 (10th Cir. 1975): “The ostensible ownership exercised through possession is demonstrated through simple physical control. One who controls the collateral possesses it, and leads others to believe it is his.”

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At first sight, there would seem to be no fundamental difference between both approaches. Both types of reasoning seem to match perfectly: the purpose of making property rights public is presented as a means to prevent problems of ‘false appearance of wealth’ and the like. Hence, whereas the first approach seems to focus on whether one can or cannot see that a security right is created, the second approach describes the transfer of physical possession as having the purpose of (contributing to) providing that information:

“It is one of the achievements of the classical model [of property law, DJYH] (...) that all property rights are public and not (...) completely hidden for third parties, especially creditors. This explains why a mortgage on immovable property has to be registered, why a pledge on movables can only be a possessory security right and why a pledge of claims can only be fully effective after notice of the pledge has been given to the debtor.”

Likewise:

“The delivering of the property pledged by the pledger to the pledgee, and the acceptance and continued possession of the property by the pledgee, is that which gives the world notice of the pledgee’s interest and the extent of his rights to the property in his possession.”

That this is perhaps more nuanced is evidenced by the fact the explanations offered for requiring possession to be transferred to the secured lender seem to conflict with one another. In fact, an examination of the legal literature on the topic shows that both supporters and adversaries of the enhancement of publicity present the very same arguments in support of their view. This raises the question as to the validity of the arguments pro and con with respect of each of these approaches. When attempting to define the exact use of public information – the purpose of Part I of this thesis – it would seem fair to attempt to straighten out the logic. In the following two subsections I will therefore try to further analyze these arguments to better understand the relationship, if any, between publicity and possession.

4. Analyzing the relationship between publicity and possession

4.1. When you think that …

The general point of departure in legal literature seems to be that problems such as e.g. the ‘false appearance of wealth’ are prevented by ‘making proprietary rights public’. If this is correct, the first question that comes to mind is what is understood by the phrase ‘making public’ or how this ‘making public’ is achieved.

24 Van Erp 2009a, p. 22. Cf. Nieuwenhuis 1980, p. 15: “To increase the security of ownership, the transfer and encumbrance of goods is bound to a public act (...). With regard to movable property, it (the law) deems that, to ensure that publicity, a material act, a physical handover, is sufficient.” (translated)

Arguing against the adoption of non-possessory security while warning for problems of ‘false appearance of wealth’ implies – at least to some scholars, including myself – that the formal requirements for creating a possessory security right (and the traditional, i.e. physical, delivery for transfer of ownership) in the 19th century had been introduced to publicize the fact that a security right is created. In this view ‘making public’ means making known to the world at large who is (becoming) the secured lender or the owner. It implies that the legal requirements of transferring physical possession were designed to convey substantive information to third parties, i.e. to actively inform them about the existence of these rights:

“The existence of the pledge is made clear to third parties by the change in the exercise of power.”

It is not very hard to argue the contrary view by pointing out that the ability of informing third parties by means of physical possession is in fact very limited. The transfer of possession as traditionally required for the transfer of ownership or the creation of a possessory pledge indeed mark the (dynamic) moment the proprietary transaction takes place – as a result of which this moment indeed becomes ‘public’ – but once possession has passed, it is impossible to deduce relevant information from the static situation that has thus come about. But there is even more: even if we could have noticed the transfer of possession, this in itself does not tell us much. It is impossible to conclude from the dynamic movement (nor from the newly arrived at static situation) that a specific legal transaction must have taken place, let alone which one. It is therefore not surprising that this argument is brought up quite frequently in legal literature:

“(…) possession by the pledge-holder cannot alone indicate that a lien over the item exists. The pledge-holder could also be the owner, lessee or custodian of the item.”

Since physical possession can mean a wide variety of things including leasing or borrowing, it hardly tells the observer anything. The introduction of the possibility

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26 Here, I mean substantive information on the question i) who holds an interest, ii) in what asset and iii) in what capacity.
27 Asser/Van Mierlo & Van Velten 3-VI* (2010), no. 146 (translated). See also no. 147.
28 Compare Dalhuisen II 2013, p. 465: “(…) if a person holds these assets, in the case of chattels for example on the basis of contractual user rights or a proprietary usufruct, or in the case of intangibles as a collection agent, who can say what the real proprietary structure in the assets is?” Moreover, it can be questioned whether third parties can be expected to see a movement of the asset from or to the (prospective) debtor, like Baird and Jackson seem to suggest: “(…) a possession-based system presumably would require enough external evidence of a change in possession to alert creditors of the manufacturer looking at the manufacturer’s operations.” Baird & Jackson 1982, p. 181, footnote 25.
of having a non-possessory interest in the asset, such as the adoption of the non-possessory pledge, obviously does not alter this fact, so the argument goes. See for example Sigman:

“(...) it is important to consider what we learn from the publicity provided by dispossession of the pledgor – in fact very little. (...) The fact of possession in a person other than the owner does not confirm that the possessor holds the asset as pledgee – it might instead hold the asset as a temporary user that has leased it, or borrowed it, or holds it for safekeeping or to repair or improve it, etc.”

It is beyond discussion that these arguments hold ground. Possession or the transfer of possession cannot make clear the relationship between the possessor and the asset that it has in its possession. That it can be very puzzling to assume the contrary, is illustrated by Kisch:

“Why is the identifying characteristic ‘power’, despite the many objections that arise against it, so perpetually and so universally designated as an identifying characteristic? (...) For a very long time, much has been made of the objections against this identifying characteristic in more than one place – yet nevertheless, the term ‘physical possession’ as a criterion for a right in rem recurs perpetually in law book and textbook.”

“However, the development of the possibilities for rights in rem (...) shows ever-increasing divergence from this principle of direct and simple visibility. The divergence between factual relationship and legal entitlement is, in its historical evolution, nothing other than the history of the development of ownership as against possession, and later of possession as against detention. With this development, the unity of rights in rem and physical possession also had to be lost.”

In point of fact, possession could only ‘publicize’ the creation of a security interest, if four requirements were met. First, every creation of a proprietary interest would have to be implemented by passing the asset to the acquirer of the interest. This would make every creation of a proprietary interest visible and, with that, identifiable by third parties. Second, any party who has acquired a proprietary interest should retain physical possession of the asset as long as he or she exercises the proprietary interest. Since third parties cannot look back in time, publicity of proprietary

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30 See Scheltema 1990, p. 404: “(...) anyone who, for instance, gives credit in the belief that there are sufficient unencumbered assets, and derives that belief only from the fact that the debtor has many movables in his possession, is acting imprudently; he should remember that our law happens to create the possibility of custodianship separate from ownership in many different ways.” (translated)


33 On the identification of conceptual structures in the context of publicity, see Zhang 2004, p. 51.

34 But also because seeing the transfer of the asset from the debtor to its creditor can actually only exist in theory. See supra footnote 28.
interests depends on what they can discover at the present time: the physical, ‘visible’ situation would have to continue until the time that third parties are confronted with that interest. Third, every public act, i.e. every transfer of the asset should signify that a proprietary interest (and no other interest) is being created. In this way the ‘visibility’ as referred to in the first requirement becomes the information that is crucial in the context of publicity, since third parties are not only informed that something is happening, but also what is happening (or has happened). Finally, the above-mentioned asset(s) transfer should mark the creation of a specific, unique proprietary interest: a security interest. Only then will ‘publicity’ as referred to by e.g. Van Erp be realized: third parties will not only know that a proprietary interest is being created, but also which one. Therefore, it seems fair to conclude that possession, when described as a source of substantive information, should never be taken literally. The fact alone that modern legal systems recognize a variety of legal relationships of a proprietary and non-proprietary nature, simply renders possession a very weak (or perhaps even worthless) means of communication.

4.2. … you are almost there …

Still, if requiring the secured lender to obtain and hold possession would not serve the purpose of ‘making known’ the creation or existence of a security interest, then what is the purpose of the physical transfer of the asset? And why would a possessory security right do more justice to the principle of publicity than a non-possessory one?

Some legal scholars habitually present the argument that the purpose of the possessory security was not to transfer the asset to the secured lender, but away from the debtor. These authors seem to focus on the dispossession of the debtor rather than on the secured lender acquiring possession. Instead of actively informing third parties about the creation of the possessory security (‘look, a security interest is being created!’), the requirement of transferring possession is said to have had the purpose of factually depriving the debtor of the possibility of misleading third parties. See e.g. Reinertsen Konow:

“The traditional way of creating a security interest in a movable is to create a possessory security interest. In these cases the security interest will only be valid against third parties if the movable is taken away from the pledger either by handing it over to the pledgee, or by other means making it impossible for the pledger to get hold of or to use the movable.”

35 Van Erp 2009a, p. 16: “(…) it must be clear upon which object a real right will rest and both object and real right must be visible to the outside world.”

36 Reinertsen Konow 2006, p. 640. See also Lukas in this sense: “(…) by a transfer of possession at least no impression is given that the debtor is entitled to unencumbered ownership of the property.” Lukas 2004, p. 99. Also Picker focuses on the debtor’s lack of possession: “What is the function of possession? Possession of chattels originally was the principal means of curing ostensible ownership associated with security interests. The rationale
These explanations for requiring the asset to be transferred to the secured lender seem to have some merit. If the law permits the debtor to hold possession of the goods, the debtor can indeed – at least in theory – pretend to (still) be the (unencumbered) owner of the assets. If the law does not allow the debtor to retain possession of the asset, the debtor simply cannot create a (false) impression at all. In this view, the possessory pledge was a legal concept that contributed to the prevention of mishaps, not to actively inform, i.e. provide substantive information to, third parties. It would explain why in creating a possessory security interest, the collateral may also be transferred to a third party, as an alternative to transferring the asset to the secured lender. In this line of reasoning it is not about what possession in the hands of the debtor can do (namely: inform), but what, once removed from him, it cannot do (namely: mislead).

4.3. …you find yourself right back at the beginning

Although this analysis would seem plausible so far, the question presents itself how possession – when held by the debtor – can create a misleading impression, and therefore, why dispossession would be necessary to avoid such a false impression. After all, if possession can signify many different legal relationships with regard to the asset and therefore does not provide any information, how can possession contribute to a false impression, by providing the wrong information? Furthermore, if one does assume that physical possession can be misleading when held by one party, does it not equally mislead when held by another? In other words, has the problem not simply shifted? Cf. Baird and Jackson:

“Strictly speaking, pledges of chattels created ostensible ownership problems as well, because the creditor holding pledged property would appear to own property that in fact belonged to another.”

commonly put forth for 9-313 is that the lack of possession of collateral by the debtor and the factual possession of it by the creditor, the creditor’s agent, or his bailee serves “to provide notice to prospective third party creditors that the debtor no longer has unfettered use of [its, DJYH] collateral” Cf. Vriesendorp & Barendrecht 1993, p. 5, Drobnig 2011, p. 1027 and Adams et al 1995, p. 883: “Because the debtor lacked possession and control of the collateral, no reasonably alert party could have been misled about the true state of the debtor’s title to the property. In other words, possession on the part of the pledge cured the ostensible ownership problem (…)”

Likewise:

“(…) potential purchasers would not have to worry that their seller had given someone else a security interest in the property. They would, however, have to worry that their seller did not own the property outright, but simply possessed it as a collateral for a loan he had made.”

A full-blown Babylonian confusion presents itself: when held by one party, an asset is said to create a false impression, but when held by another party it is said to provide information. Or conversely: when held by one party, an asset is said to not give (correct) information and thus to create false impression. It is sometimes difficult to keep track.

In the analysis as to whether the adoption of a public filing system would be useful, this Babylonian confusion may lead to the following result. Opponents of a public filing system may put forward that (transfer of) physical possession has never contributed to making rights public and can therefore not be put forward as a legitimate reason for introducing a public filing system. Supporters of a public filing system, on the other hand, may comfortably argue the exact opposite: from the fact that someone can hold an asset by virtue of countless different legal relationships, they may draw the conclusion that there are in fact many situations in which the risk of false appearance demands disclosure of public information. In their view, false appearance is created not only by the non-possessory pledge, but exists also if the debtor has borrowed or leased the asset. As a matter of fact, even putting the asset in the hands of the secured lender will then create a problem of ‘false appearance’ and a filing system can – and should – provide an answer to all of these problems.

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38 Baird & Jackson 1984, p. 307. See also Baird & Jackson 1982, p. 181: “Should the lender cure the ostensible ownership problem by taking possession of the property himself, the focus of the ostensible ownership problem shifts from creditor of the manufacturer to creditor of the lender.”

39 These scholars will be able to argue that publication of property rights by means of public notice filing would not provide additional value because publication would merely present facts already known to creditors. See e.g. Beekhoven van den Boezem & Goosmann 2010b, p. 44. Cf. Mooney: “Because it is commonly known that business equipment often is subject to security interests, one might argue that such common knowledge justifies the abolition of a filing requirement for secured transactions as well.” Mooney 1988, p. 739. Cf. Van den Heuvel 2004, p. 91 and Pitlo/Brahn, Groot & Breemhaar 1980, p. 474.

40 See, for example, Simkovic 2009, p. 290 arguing for a more-encompassing Art. 9 UCC filing system: “Unlike previous recordation systems, the system should be universal. It should incorporate all liens, in any form of property.” According to Van Erp, for example, retention of title (but also the transfer of ownership for security purpose) is looked upon with great suspicion, not only because these legal instruments result in ‘fragmented’ ownership between a creditor (‘legal owner’) and a debtor (‘economic owner’), but also because they are non public – in Van Erp’s words secret or ‘occult’ – forms of security rights, unknown to third parties; see Van Erp 2009a, p. 22. Cf. Baird & Jackson 1982, 186. This does not culminate in requiring registration of all forms of detention other than on the basis of ownership, but that is as far as the American notice filing is concerned according to these American authors, merely a matter of choice, based on considerations of efficiency.
Chapter 2

5. Reasons for confusion and possible explanations

5.1. ‘Possession’: a multi-headed dragon

When the use of ‘possessory security’ or the aim of ‘publicity’ are discussed without a clear background and context, the battle between supporters and opponents of public filing will be endless, as it causes the publicity subject to be approached from completely different angles and abstraction levels. If one is not aware from what perspective any given author approaches the doctrine of publicity, one risks to be caught in one of Escher’s deceiving trompe l’oeil-drawings: when you think you are almost at the end, you suddenly find yourself right back at the beginning. If you look more closely, you will see that supporters of a public filing system may even be caught in one of Escher’s deceiving trompe l’oeil-drawings: when you think you are completely different angles and abstraction levels. If one is not aware from what a clear background and context, the battle between supporters and opponents of publicity is also infected by the principle of ‘false appearance of wealth’. In this line of reasoning, public filing would be useful because third parties would have an interest to investigate whether perhaps the opposite could be true. In this subsection, I will demonstrate that the ambiguous concept of possession is the source of all evil, as it functions as a multi-headed dragon that can be used to argue both in favor and against public filing. It almost seems to be just a matter of taste whether the importance of (public) filing is applauded or downplayed.

The main problem seems to be that scholars tend to rely very much on generalities such as the ‘false appearance of wealth’, ‘third parties’ and ‘the world at large’, while at the same time focusing too much on what possession may or may not be capable of. As a result, problems such as a ‘(false) appearance of wealth’ are presented as to be caused by possession itself — i.e. by the mere presence of the assets — rather than by the debtor. Accordingly, the need for publicity is presented as more pressing, i.e. of interest to more parties, than it really is. See, for example, Mubiana & Ngenda:

“(…) it is often necessary to perform an act which puts third parties on notice of the security interest. This additional step is designed to give notice of the security interest to the world and any would-be purchaser or encumbrancer of the secured asset. Taking

41 See Sigman 2008, pp. 143-165.
42 See for example Lipson in this respect, which has a point, but abstracts too much from reality: “The ambiguity of possession also infects the creditor’s side of things. For example, even if a lender has actual physical possession, we still do not know what to make of potential creditors of the possessory creditor. After all, it is entirely conceivable that A (B’s creditor) may take possession of B’s property to secure B’s obligation. But is it at least theoretically possible that A may have its own creditor or purchaser (C). Why should C be any less gullible than B’s creditors? Does not A’s possession of B’s property signal to A’s secondary stakeholders, such as C, the very same thing that B’s possession would signal to B’s creditors, etc.? How could C know from observing A’s possession that B retains an interest (e.g. equity) in the property?” Lipson 2004, p. 454.
It seems to be even more irrelevant to focus on what possession might have been capable of in the past. Scholars who see merit in ‘more publicity’ may stress the importance of a public filing system by arguing that possessory security (or the traditional, physical, delivery) used to give substantive information about the proprietary position of its holder. The fact that it no longer does may then be used as an argument to promote a system that would provide this information once again:

“In ancient times, factual and legal positions tended to coincide almost perfectly. (...) He only regarded himself the owner of the spear as long it was within reach.”

Scholars who see no merit in ‘more publicity’ may do the exact opposite, by focusing entirely on the fact that possession – because it can signify a variety of relationships – is not, and never has been, capable of informing third parties about the existence of a security interest and thus cannot mislead them either. As a result, they can accuse the supporters of public filing of relying on arguments that constitute the ultimate contradicton in terminis. How can it be that possession is not in any way informative, whilst it can nonetheless be misleading? And if that is so, then why do we need public filing in the first place?

“[The, DJYH] objection [that the non-possessory pledge gives rise to the possibility that third parties will be deceived by a false appearance of creditworthiness, DJYH] is weak. A false appearance of this kind also occurs when A [i.e. the ‘debtor, DJYH] has something on rental, hire purchase or lease.”

In my view, the justifications for publicity must be found some place else.

5.2. Justifications for publicity
Public filing deserving pursuit because security rights have been public in the past is not a very convincing position to take. First of all, it is not very likely that (the transfer of) possession has ever contributed to making security rights ‘public’ in the

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43 Mubiana & Ngenda 2009, p. 279 (footnotes omitted). Cf. Comments A to IX. – 3:201 (DCFR): “(…) in the context of the traditional pledge, possession by the pledgee was and still is the central requirement to bestow proprietary effect, i.e. effect against all the world on the pledge”, and ‘A Guide to Movables Registries’ (Manila: ADB, 2002), p. 7: “(…) registration in a movables registry (…) reduces legal risk in secured financing transactions by publicizing notice of a charge over assets in the possession of the debtor to interested third parties, such as subsequent buyers or the debtor’s other secured and unsecured creditors.” Compare Van Erp & Akkermans 2012, p. 1012: “The one overarching distinguishing characteristic of property rights is that they can be enforced against an indefinite number of people or – in other words – have an erga omnes effect.”


first place. Even before various European legislators in the 19th century began to only tolerate possessory security in their Civil Codes, it had been possible to own an asset while renting or leasing it out at the same time. Modern legal trade simply exists on the strength of the admission of a variety of personal and proprietary interests in respect of tangible assets. Moreover, even if a direct relationship between possession and proprietary rights did in fact exist in some distant past, this fact alone in my view provides insufficient basis for the pursuit of public filing. For the very same reasons it is not convincing to justify the need for public information by the publicity dogma, without any further scrutiny of that dogma or considering adjustment to the needs of modern times. It is just too easy to argue that the world at large is in need for public information; dogmas have usually developed in the concrete context of addressing certain problems or specific needs.

For the very same reason those who argue that public filing does not deserve pursuit because a possessory pledge did at no time contribute to making security rights public (on the basis that possession in itself has never been capable of informing third parties about the legal relationship in respect of the asset because it can signify a variety of different (legal) relationships), equally miss the point. Although their observation represents an absolute truth, it disregards the question what purpose public information serves or should serve today.

It is important to recognize what needs existed when the publicity dogma developed and to consider whether these may exist still today. Where it comes to the problem that is cited most, ‘the false appearance of wealth’, it is beyond doubt that this problem does not exist – and has never existed – in the abstract, i.e. in relation to the world at large. Assuming the contrary would imply that third parties are misled by the mere presence of the assets, rather than by the debtor interacting with others in respect of them. Hence, scholars who criticize the false appearance of wealth doctrine on these grounds have a point: modern legal systems permitting various legal relationships to exist in or with regard to one asset is not only a matter of fact (see supra subsection 4.1.), it is also a fact of common knowledge. But one could also carry these doubts too far. The mere fact that possession can signify many different relationships does not mean that certain types of third parties cannot be misled by the debtor holding possession and, moreover, that this problem may not be effectively addressed by the introduction of a public filing system. In other words, the truth would seem to be somewhere in the middle. When the false appearance of wealth doctrine is redefined to a problem of ‘deceit’ that may be committed by the

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46 Mooney presents a similar argument: “The common thread running through the development of chattel security law was a pervasive judicial and legislative concern about fraud. This fraud concern is separable from the ostensible ownership concern that possession of personal property begets misleading appearances of ownership upon which creditors and purchasers may rely. Unfortunately, the failure of many courts and commentators to make this
debtor in relation to specific types of parties, this would better explain why the non-possessory pledge was castigated in the 19th century. Although such kind of deceit undeniably also existed before the introduction of the non-possessory security (the debtor could also create false impressions with regard to leased or borrowed assets), the possibility of taking non-possessory security did indeed intensify the problem, as it resulted in another possibility of deceit, but now committed by the debtor with respect to assets that were already pledged. At the same time it would clarify what practical purpose possessory security served, given that such fraud was clearly and understandably in the first place a concern in the context of businesses, i.e. debtors. Requiring the debtor to hand over its assets to its lender simply made it impossible for the former to pledge such assets again or to transfer them without being authorized to doing so.

The idea that third parties would be put on notice by the fact that they can observe the assets being moved to the lender is perhaps somewhat theoretical, but the fact that the assets were no longer present with the debtor at least warned buyers or second-in-time lenders that something might be wrong as it implies the assets are held by another party. In my view, this was the logical explanation for only permitting possessory security: this was to eliminate the risk of the debtor fraudulently pledging an asset twice to secure two unrelated loans.

47 When a factual situation does not correspond with the substance of a legal relationship – which is often the case, such as custody, non-possessory pledge, retention of title, lease etc. – third parties by definition run that risk of being misled, simply because these concepts give room to the debtor to pretend it is the (unencumbered) owner of the good it holds. Generally, these rules apply to successors in title only, because these successors are considered to be potential victims of deceit.

48 Thus, the argument that publicity has no additional value because before the adoption of non-possessory security it had not been either possible to recognize the legal relationship between the debtor and its assets is therefore beside the point.

49 Cf. Livingston for U.S. law: “Because the debtor had to surrender physical possession of the goods to the pawnbroker, that action by itself put third parties on alert that the debtor had already given an interest in its property to someone else.” Livingston 2007, p. 115.

50 This should put third party-buyers or lenders on inquiry. See previous footnote, Mubiana & Ngenda 2009, p. 279: “Possession of security was developed at common law. It is the safest method of perfection as it puts all those dealing with a debtor, of whom possession has been diverted, on inquiry and is thus as good as notice to the world at large” and Goode 2010, p. 690: “Diverting the debtor of possession puts anyone dealing with him on inquiry and is thus equivalent to notice to the world at large.” This is sometimes referred to as ‘negative publicity’, see infra footnote 61.

51 Different: Simkovic 2009, p. 257: “Under secret lien doctrine, it is not fraudulent intent that matters, but a lack of notice and meaningful disclosure.” Simkovic is even of the view “that a lack of transparency threatens...
The result of this interpretation of the false appearance of wealth doctrine is that the 
*contradictio in terminis* as to the alleged shift of the problem (now the lender, having 
possession, can pretend to be the owner of the assets, although it is nothing more 
than a secured lender; see *supra* subsection 4.2.) is without merit. While it is 
conceivable that the secured lenders could thus commit deceit of this kind, it is 
likely that the possessory pledge was mainly designed to protect lenders against 
fraud committed by their debtors and not to prevent *lenders* to commit such deceit.52

### 5.3. The roots of the modern publicity principle and its development

The foregoing observations have led me to believe that the principle of publicity can 
be read in two different ways. It could be interpreted as an outright call to publicize 
security rights as much as possible (*i.e.* to adopt a public filing system), but it could 
also be interpreted as an expression of the belief that property rights should not be 
enforceable against third parties, *unless* these rights were public to them. In this last 
interpretation, the principle of publicity would embody the belief that certain types 
of parties deserve protection from the risk that a debtor may abuse the fact that 
property rights are *not* public, but nothing more than that. In my view, it is very 
likely that the publicity principle originally developed from this last idea as it can be 
found as the basis of typical *bona fide* protection rules. I also believe that references 
to ‘possession’ as a means to ‘making public’ of security rights should be seen in the 
light of the development of these rules.

At the time that technology was not so far developed that security rights 
could be easily publicized, many legal systems introduced third party protection 
rules to address situations in which debtors could deceive third party buyers or 

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52 Some scholars have pointed out, and in theory this is correct, that lenders can also be borrowers 
and therefore even they could be tempted to re-pledge the assets that they have taken in possessory 
pledge: “‘Courts and commentators ignored this problem, perhaps on the ground that those who were creditors were 
not likely to be borrowers as well. Regardless of whether this rationale was ever sound, it is no longer. Many legal 
institutions (such as banks) are also borrowers.” See Baird 1983, p. 54, footnote 5. I agree with this 
observation, but I believe that this was not considered a serious problem in practice in the 19th 
century. Given the nature of the assets on which lenders would have had a possessory pledge, for 
example, it would not have been easy to succeed in committing such deceit.
secured lenders. Pursuant to these rules buyers and secured lenders that mistakenly relied on the debtor’s pretention of (unencumbered) ownership were granted protection, by allowing them to keep the right they anticipated at the expense of a prior-in-time owner or secured lender. Books have been written about the question where to strike a balance between the entitled party and the disappointed successor, and there is no single answer among the different legal systems. Despite these differences in outcome, it is an established fact that many jurisdictions take the fact that the debtor had possession of the assets as one of the elements to establish a third party’s good faith.

“For decades, law students have been taught that the acquirer of a movable deserves protection because he should be able to rely upon the actual possession of the transferor; this actual possession legitimizes the transferor as the owner, or – in the words of the National Report of Slovenia the possession of the transferor “creates an image of ownership”.”

That possession plays an important role in these third party protection rules is understandable as it will always be one the main factors why third parties have put confidence in the debtor that has sold or offered its assets as collateral. It does not, however, render possession a viable means to provide information in respect of the questions i) who holds an interest, ii) what kind of interest, iii) in what asset and iv) in what capacity; questions that really matter in the context of the doctrine of publicity or, in my view, that are considered to be important nowadays.

Another possible explanation for the fact that possession is often referred to as a means to make property rights public, may relate to the fact that in many legal systems possession raises a prima facie title or a presumption of the right of property in the asset so possessed (according to the concept of possession van titre). In my view, such rules serve solely the procedural purpose of evidence for the protection of the entitled party. Since in practice the asset will remain most of the time in the physical possession of the entitled party, that party deserves the...

53 Cf. Adams et al 1995, p. 882: “Where there was no system for recording encumbrances on chattels, creditors or purchasers had no reliable means for discovering a secured creditor’s interest, which therefore was a secret lien. For this reason security arrangements that left a debtor in possession of the collateral generally were unenforceable against innocent third parties.” See in particular footnote 22, which sets forth illustrative case law.

54 See e.g. Salomons 2007 and Salomons 2011b, who presents an overview of the different solutions to the problem of bona fide acquisition in different European legal systems.

55 Salomons 2007, p. 11. (footnotes omitted)


57 In Dutch law, for example, there is a statutory rule to the effect that the ‘holder’ of an asset is presumed to hold such asset for itself (Art. 3:109 BW), as well as a rule to the effect that if one holds an asset for itself this creates the statutory presumption of ownership (Art. 3:119 BW).
benefit of procedural advantage should anyone contest its right.58 Such rules also, however, are not to the effect that physical possession would produce any substantive information about the relationship between the possessor and the asset that he/she has in possession.59

This does not mean that publicizing security rights may not be useful, quite the contrary. When third parties can verify the existence of security interests in a public filing system, deceitful transactions will be minimized rather than settled at the expense of one of the parties concerned. Publication of security rights will therefore contribute to the prevention of the aforementioned conflicts between first-in-time owners or lenders on the one hand and second-in-time owners or secured lenders on the other. In my opinion, advances made in technology have caused the publicity principle to develop into the idea that publicizing security and other proprietary rights is something we should strive for, simply because it seems easily attainable.60

Hence, I believe that the original publicity principle has given way for a more modern reading of the publicity principle as to entail a call for public filing. In theory, this modern version of the publicity principle is better than the old one because it serves the interests of third parties across the full spectrum: both first-in-time owners and lenders and not second-in-time (‘third’) parties ‘win’ as the conflicted is avoided in the first place.61 The question posed in this thesis is whether such kind of deceit is still a serious risk today, and if so, whether a public filing system can prevent this risk in a cost-efficient manner for the parties involved in such conflicts. In addition, this thesis will investigate whether perhaps there are other third parties that experience problems that could be avoided by publicity.

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58 Different: Asser/Mijnssen/Van Velten/Van Mierlo 2003, nr. 203: “A third party desiring to acquire an asset will, on the basis of the physical possession by the party with the right of use, presume such party to be the owner of the asset. After all, on the basis of Art. 3:109 that third party may assume that whoever has physical possession of a tangible asset has such possession for himself. That possession legitimizes the possessor as being the legal owner on the basis of Art. 119 BW.” (translated)

59 Cf. ‘Discussion Paper on Moveable Transactions (no. 151)’ (Edinburgh: The Scottish law Commission, 2011), p. 94: “Even outwith the context of security, there can be possessors who are not owners and owners who are not possessors, so that the link between possession and ownership is not strong; though possession raises a presumption of ownership, it is a presumption not hard to rebut. A third party can never expect to be certain about title to goods.” (footnotes omitted)

60 See supra Chapter 1, section A.3.

61 I already mentioned above that I believe that in the 19th century allowing possessory security only may have served a similar (practical) function: by taking away the assets from the debtor, the debtor was simply prevented from fraudulently transferring assets that were not (yet) his own or from fraudulently pledging its assets to two different lenders. It was only the method that was different: in the past ‘negative publicity’ resulted from taking the possession away from the pledgor, while at present registration is expected to provide ‘positive publicity’; see Dirix 2004, p. 84 and supra footnote 49 and 50.

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6. Concluding remarks

The discussion about the use of ‘more publicity’, i.e. the use of public filing is severely polluted by a Babylonian confusion.62 This is caused by a variety of reasons. First of all, the subject is not in itself discussed in any great detail and secondly ‘publicity’ and ‘making public’ are – to say the least – vague notions. In many cases, it is not made clear by the writer what he means by publicity and in what respect publicity is pursued: should it be seen as substantive information about who holds a security interest, does it serve as a mere warning that a security interest is in place or are there perhaps other hidden motives or meanings? Consequently, arguments based on one view may be used to rebut positions taken on the basis of the other and vice versa. If we allow ourselves to believe that forms of possessory security as well as the traditional requirement of physical delivery were once introduced to provide substantive information, i.e. ‘publicity’, to third parties, we are bound to lose track, especially if the purported problem of false appearance of wealth – for which this substantive information would be the purported solution – is taken as a justification to provide this information. The temptation to lump both approaches together is considerable, because they lead to the same result: irrespective whether one wants to ‘inform’ third parties or to ‘prevent a false appearance of wealth’, the point seems to be to make information public. The dogma concerning publicity fits both ideas perfectly:

“The principle that property rights have third party effect requires those rights to be public.”63

The means to achieve both goals also seem to be the same: transfer of the asset from the debtor to the secured lender. Yet, the publicity concept has greater nuance than meets the eye and ‘informing’ and ‘preventing a false appearance’ are not necessarily two sides of the same coin. On the one hand, possession being ‘informative’ should be interpreted mostly metaphorically, since it refers to generally acknowledged notions that afford ‘physical possession’ an important place in certain rules on third party protection (see infra subsection 5.3.). On the other hand, the idea that a prohibition of non-possessory security rights ‘contributed’ to the publicity doctrine should not be taken literally either: the objection against the introduction of non-possessory security was in my view based on the fear of a potential statistical increase in the risk that the businesses would deceive their lenders in asking for credit; the issue

62 When referring to ‘the Babylonian confusion’, I mean the confusion which allows some scholars to argue ‘that possession can mean anything’ (incl. lease, etc.) and therefore cannot inform, while others can argue that possession is not capable of creating a misleading impression ‘because it can mean anything (lease, etc.)’.

Chapter 2

was thus not that possession in the hands of the secured lenders had at one time given correct information to third parties, and now no longer does.\textsuperscript{64} Not were secured lenders seriously suspected of such deceit. Insofar as the possessory pledge had hitherto been applauded for these reasons, it was therefore in my view on incorrect grounds.

Now, one might ask what is so bad about juggling with the abstract notion of possession. It undoubtedly gives academics a great opportunity for philosophizing, but it clouds our vision. It prevents us from getting down to the real nitty gritty, the true substance of the question: why is public information on security interests so important and to whom? This analysis will be conducted in Chapters 3 through 4.

\textsuperscript{64} This could involve deliberate deceit, which would be pure fraud; however, the debtor can also commit deceit and be unaware of it, for example because it does not know which of its assets were pledged to an earlier creditor.