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 4
Analysis of the consequences of a non-public filing system
1. Introduction

The previous chapter illustrated how a system of non-public filing is structured, giving a description of its legal rules and a general description of how lenders and trade creditors use—and operate within the boundaries of—these rules. The aim of that description was to show how such a non-public filing system functions, simply because very few such systems remain. More importantly, it served as an exploratory example. By demonstrating what happens when certain types of parties involved in secured transactions cannot inspect a filing system, we may get an idea of what problems a public filing system might be capable of solving, and if so, to what extent.1

This chapter will recapitulate the findings, re-analyzing them and drawing conclusions concerning the relevance of public information for various types of parties involved in secured transactions. First, I will investigate whether, and if so to what extent, the absence of publicized information on security rights can be a source of harm to several types of parties dealing with the debtor, because it puts them in a more adverse position than if that information had been publicly available. Furthermore, I will analyze the consequences for the debtor.2 In doing so, I will try to fathom the essence of the principle of publicity: to what extent should property rights be public and to whom—or for whose benefit? The answer that this chapter gives to the question what problems are caused specifically by the absence of publicity will allow us to investigate if and to what extent the U.S. notice filing system would solve these problems, in Part II, and hence to answer the main question of this research, i.e. whether we should strive for a European equivalent of this notice filing system, in Part III.

2. Unsecured creditors

2.1. Introduction; the perceived problem(s)

One of the perceived problems relating to the absence of public information—as is the case in the Dutch, the German and the Austrian legal system—concerns the position of unsecured creditors.3 The reasoning seems to be that if information on security rights is not publicly available, potential unsecured creditors run the risk of conducting trade on the false proposition that the assets of their debtor will be available for recovery of an unpaid debt. In other words, the debtor would seem to be wealthier than it actually is. As Bridge illustrates, this was an important motive for adopting a public register in the U.K., back in 1900:

1 Cf. supra Chapter 1; subsection C.1.
2 Cf. supra Chapter 1; subsection D.1.
3 Among many others, see Beale 2008, p. 96, mentioning ‘unsecured creditors’ as one of the categories in need of publicity: "There should be adequate warning to other potential secured parties, to unsecured creditors, and to persons who may wish to buy or lease the debtor's property when it is or may be subject to a security right."
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“A clear motivation behind the duty to register from the outset was the belief that the concealment of secured credit was an evil calculated to mislead those dealing with the company. The requirement of registration was designed for the protection of those doing business with the company so that they might see how much of a company’s assets would be available for distribution in any insolvent liquidation.”

Similar considerations seemed to have played a role in the U.S.:

“A history of chattel security could be well written in terms of 400 year-struggle by debtors and their secured creditors to create security interests of various sorts in the debtor’s property without affording notice to buyers or other creditors, and the attendant demands by unsecured creditors generally for some kind of notice when all or part of the debtor’s assets become subject to security interests.”

Although some consider this notion to be rather outdated, similar arguments can still be found in contemporary European and U.S. literature where the use of a public filing system is discussed. For the European context, see e.g. Drobnig, recalling the motives for the requirement of dispossession of the debtor, and hence one of the perceived functions of publicity for potential (unsecured) creditors (see in the context of this subsection his referral to the second function):

“The debtor’s dispossession fulfills two major functions: it makes it more difficult for the debtor to dispose of the pledged goods to a third person; and the debtor can no longer create the misleading impression in the minds of his other creditors of owning the pledged goods which might be available for the satisfaction of their claims.”

It seems that the arguments stem from the belief that information with regard to security rights in the debtor’s assets is useful to the latter’s potential creditors, because it gives them the opportunity to decide whether to enter into a (credit) relationship, and if so, under

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4 See Bridge 2008, p. 186. Bridge says further that registration would also (hence, apparently not mainly) do much to clarify the rights of secured creditors if the company went into liquidation and the rights of those purchasing the company’s property, since it avoids the evils of backdated documents and provides the charge with a badge of authenticity. This function of publicity will be discussed in subsection 3.2 of this Chapter.
5 Coogan 1962, p. 289.
6 See the many references in Chapter 2, section 2 and e.g. ‘Company Security Interests’ (London: The Law Commission, 2005), p. 32 on the related subject of the registration of outright sales of receivables: “Requiring that outright sales be registered would also provide unsecured creditors with valuable information about the company’s finances.” And on p. 133: “The reason for denying effect to a charge that has not been perfected by either filing or control is to make sure that unsecured creditors and other parties (including potential second secured parties) dealing with the company have a chance to discover the charge.”
7 LoPucki, Abraham & Delahaye 2013, p. 1788 describe ‘The Deception Problem’ as one of the two main policy objections to security: “The essence of the Deception Problem is that debtors who have granted security interests appear to have wealth, but do not. The effect is to deceive third parties who extend credit without knowledge of the pre-existing security.”
8 Drobnig 2011, p. 1027.
what conditions. The assumed problem seems to be that, unless such information is publicly available, potential creditors run the risk of entering into a (credit) relationship which they would not have done had they known the facts, or without having had the opportunity to stipulate additional (protective) conditions, such as taking collateral or – if that is not possible or feasible – asking for a higher price. See e.g. Van den Heuvel:

“The safeguard offered by publicity is that potential creditors, by consulting the register, can find out whether, and if so to what extent, the assets are already encumbered with security rights in favour of other creditors. This information is important for creditors who, before proceeding to grant credit, want to find out the scope of their right of recourse in concrete. On the basis of this, they can decide not to grant credit because of the lack of unencumbered assets, or to take account of the increased risk due to those security rights by increasing the price of the credit they grant.”

See also commentary by Schwartz:

“Secured creditors will charge lower interest rates because security reduces their risks, but unsecured creditors will raise their rates in response because security reduces the assets on which they can levy, and so increases their risks.”

This therefore boils down to a feeling that unsecured creditors, i.e. creditors that have not stipulated security, have missed out on something by not having public information with regard to security rights if they have not raised their price either. That this is also one of the motives underlying the U.S. public filing system can be seen from many U.S. based sources, including Dunham, describing the main reasons for filing in the U.S. immediately prior to the adoption of the U.S. notice filing system in 1949:

“As far as inventory financing is concerned, the traditional protection [of unsecured creditors, DJYH] has been sort of publicity to the secured lending – that is, to require notice of the lien to be in the public records as a condition to the lien’s validity against creditors. This, it is argued, gives creditors a chance to find out that they cannot rely on a prospective debtor’s assets as a source of payment of debts.”

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9 Cf. Simkovic 2009, p. 290: “With such detailed and reliable information, creditors could rationally decide for themselves whether to extend credit, on what terms and at what price.”

10 Van den Heuvel 2004, p. 91 (translated). Here Van den Heuvel makes it clear that she understands the provision of credit to also include ‘trade credit’. She therefore understands potential credit providers to also include potential trade creditors. However, she adopts a critical attitude toward the importance of publicity precisely in relation to these trade creditors.

11 Schwartz 1984, p. 1054. See also Livingston 2007, p. 149, Wittman 2006, p. 286: “By having collateral, they are willing to lend at lower rates” and Steven 2008, p. 11.

12 Dunham 1949, p. 610. Cf. Philips 1979, p. 7: “Because perfection is a legal conclusion that enhances the rights of the secured party to the collateral in relation to the rights of others-including purchasers of collateral, transferees of the collateral, unsecured creditors, or other secured creditors these other parties should be able to make their credit or purchase decisions with the perfected secured party’s interest in mind” and Harris & Mooney 1994, p. 2064: “We see nothing unfair or untoward about permitting a secured creditor to go to the head of the line when earlier-in-time creditors have not chosen to
And, more recently, Adler, Baird & Jackson:

“Concern about the problem of ostensible ownership animates Article 9. Article 9 creates a strong policy (respected, we shall see, in bankruptcy) against ‘secret liens,’ that is, security interests that purport to give a property interest to a creditor while the debtor appears to the world to own such property.”

This assumption can also be found present in international reports on the use of public filing. In the following subsections I will examine if and to what extent, this assumption is actually realistic, using the Dutch legal system as an exploratory example.

2.1.1. Point of departure

Taking the fate of unsecured creditors to heart makes sense, given that their sole prospect of recovery is to take recourse on the debtor’s assets. In consideration of this interest, it cannot be denied that availability of the debtor’s assets says something in the abstract about whether or not creditors would be satisfied. After all: the more assets are ‘free’ for recourse, the more proceeds can be used to pay unsecured creditors by means of attachment or execution of the assets. However, to assume that this information would actually help to provide guidance as to whether these creditors should enter into the relationship at all, or whether this should be done on a secured or unsecured basis, is quite another thing. In relation to both unsecured trade creditors and unsecured lenders this seems to be unlikely or, at least, to be more nuanced.

Trade creditors are commonly considered as unsecured creditors, both in practice and in legal literature, thus their position will be discussed first.

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obtain security themselves and all creditors have an opportunity to discover the existence of the secured creditor.” See also LoPucki, Abraham & Delahaye 2013, p. 1798 et seq.
13 Adler, Baird & Jackson 2007, p. 15.
14 See e.g. De La Campa et al., ‘Making Security Interests Public: Registration Mechanisms in 35 Jurisdictions’ (Washington DC: IFC, 2012), p. 6: “Grantors, potential secured and unsecured creditors, and potential competing claims have an interest in the information contained in a collateral registry and in its availability.”
15 In U.S. and European literature, the terms ‘general creditors’, ‘unsecured creditors’, ‘ordinary creditors’ and ‘trade creditors’ are used interchangeably. In this thesis, I use the term ‘trade creditors’ to allude to sellers of movable assets that have sold and supplied their assets to the debtor on credit terms. The term ‘unsecured trade creditors’ should be understood to mean suppliers of movable assets that have not stipulated a security interest or retention of title. See also Chapter I, subsection D.1. on this.
16 It seems that ‘secured creditors’ are often considered by implication as a synonym for lenders, because lenders typically require collateral security for their credit exposure to companies. Unsecured creditors, on
2.2. (Potential) trade creditors that decide to enter into a relationship on an unsecured basis

On the question on what grounds trade creditors base their decision to enter into a business relationship on credit terms and what those terms should be and, if they have a choice, how they select one customer over another, only limited information is available. The cited Atradius credit insurance surveys suggest that trade creditors, when deciding to sell on supplier credit terms, take no account of whether their potential debtor’s assets have been pledged. Not only is the question whether security rights have been created in the debtor’s assets not mentioned at all as a factor that would influence the decision to enter into a trade relationship on credit terms, the reports also indicate that the main reasons for Dutch companies to decide to sell on credit terms were found to be (in order of importance): ‘track record’ of the debtor, ‘familiarity’ and ‘credit check’. Here, ‘track record’ and ‘credit check’ provide a perspective on the debtor’s payment history, whereas ‘familiarity’ refers to the knowledge of the customer based on experience or as a result of economic, cultural or geographical proximity.

The aforementioned results as presented in the Atradius reports could be explained in several ways. The interviewees involved in the surveys may simply not have been asked the relevant specific and open questions; the reports make no mention of what questions were asked. But even if the relevant questions were asked, the results may be explained by the fact that Dutch trade creditors simply do not have the opportunity to check a public filing system, as Dutch law simply does not provide for it. Given that the Atradius reports on other participating countries where a public register is available produce similar results, this is not necessarily a logical explanation. For the businesses in a country with a (well-) functioning filing system, such as France, the main factors that play an important role in the decision to sell products or services on credit terms are found to be: ‘track record’, followed by ‘familiarity’ and ‘reputation’. The same goes for Great Britain, where respondents ranked ‘credit check’ first in terms of importance, followed by

the other hand – also quite frequently referred to by other names; see supra the previous footnote – seem to be implicitly taken to mean suppliers of movable assets, i.e. ‘trade creditors’.

17 Supplier credit is an important source of financing for businesses, as it alleviates working capital needs. This applies to business in and outside the Netherlands; see supra Chapter 3, footnote 281.

18 Cf. supra Chapter 3; subsection 3.2.1.

19 “Reputation” is an intangible factor related to the perception that stakeholders have of a company from an economic/social/ethical point of view.” See Atradius Payment Practices Barometer – Survey of payment behaviour of international companies – Summer 2010, p. 10.
‘reputation’ and ‘track record’.\textsuperscript{20} The most important reason for approaching these reports with caution is the fact that they were not written in the line of independent scientific research, but were instead created by a commercial entity that has an interest in selling credit insurance. They may therefore not be free from bias.\textsuperscript{21} The fact, however, that trade creditors take no account of whether their potential debtor’s assets have been pledged can also – and should in my view – be argued by reference to common sense.

The proposition that trade creditors enter into an unsecured business relationship simply because they had no access to public records concerning existing security is in my view without merit for several reasons. First, this suggests that certain trade creditors, in conducting trade, assume that their prospective debtor’s assets are unencumbered.\textsuperscript{22} The adoption of a public filing system, which after all is said to be designed to make security rights public, would in that view assist those creditors. I do not share this line of thought, however, since the extensive encumbrance of assets is standard business practice (both in and outside the Netherlands) and in any event in the Netherlands is a matter of common knowledge.\textsuperscript{23} Secondly, this line of thought implies that trade creditors would refrain from taking security, not only because they have satisfied themselves by reference to the public register that their debtors assets were unencumbered, but also because they must have made the assumption that the assets will remain unencumbered until such time that the supplier has been paid: after all, an unsecured creditor always ranks behind another creditor from the moment the latter takes a security interest.\textsuperscript{24} Clearly such assumption is illogical. The existence and extent of encumbrances that prospective creditors can see at the time of supplying credit says absolutely nothing about whether this may change in the future, when they have become a creditor. The pool of assets can and will shrink or swell every day and in fact creditors are, or should be, aware of that fact:

\begin{itemize}
\item \textsuperscript{20} Atradius Payment Practices Barometer – A survey of the payment behaviour in European companies – Results Winter 2010, pp. 18 and 22.
\item \textsuperscript{21} For example, Atradius might feel encouraged to create the impression that selling on credit terms is riskier than it actually is.
\item \textsuperscript{22} At least, this is what the often referred to false appearance of wealth-argument suggests: that unsecured creditors are induced to entering into a business relationship with the debtor by the (false) appearance of wealth caused by the physical presence of the assets. See, amongst many others Pitol/Brahm, Groot & Breemhaar 1980, p. 474 (translated): ‘(...) as a result of the non-possessor 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.’ See Chapter 2 on this subject.
\item \textsuperscript{23} Therefore, if one might assume anything in the absence of public information that proves the contrary, it would be logical to assume the most usual scenario (and moreover it would be wisest to take account of the most ‘adverse’ scenario). Cf. e.g. Van den Heuvel at p. 91.
\item \textsuperscript{24} For Dutch law, see Art. 3:277(1) BW and Art. 3:278(1) BW, as discussed in subsection 2.4.1 and 2.4.2 of Chapter 3. Such a security right can secure both new and existing debt.
\end{itemize}
“The general creditor whose debtor falsely indicates that a piece of property is unencumbered is ultimately no worse off than one whose debtor later encumbers the property in violation of an express promise not to.”

“Ascertainment that there is no filing against a debtor would not provide an existing or prospective unsecured creditor with any protection against the debtor subsequently encumbering some or all of its assets.”

Some scholars seem to believe that this risk would be addressed by the introduction of a public filing system, because unsecured (trade) creditors — despite the risk they have either consciously taken or had no choice but to accept from a commercial business perspective — would be able to check the register every day, or at least on a regular basis. In this argument, publicity is deemed to be in the interest of existing trade creditors; and the ‘warning’ that would be provided in the form of a public filing would give these creditors the opportunity to tighten their conditions. That this argument is not necessarily convincing follows from the fact that this type of signal will always come too late: unsecured creditors already run the risk from the moment they have extended unsecured trade credit. If trade creditors really make a one-to-one link between the existence of security rights and the creditworthiness of their potential debtor, they should not have entered into the relationship at all, precisely because everyone knows that it is not uncommon for debtors to pledge their assets to their banks. The basic point here, however, is that information on the availability of assets of the debtor in fact says very little about whether the debtor will be able to pay its debts when these fall due. Put more subtly: if assets are encumbered with security rights, this does not mean that there is a greater risk that trade creditors will not be paid. Sometimes, it may be an indication that trade creditors will continue to be paid, since there is a lender willing to fund the business with new money. In such case, the pledging of the debtor’s assets is an indication that the debtor is receiving credit, which will keep the business running and is good news, precisely because the general trade creditors are paid from it. Consult the notable observation of U.S. practice by Smith with relation to the publicity topic:

26 Harris & Mooney 2006, p. 159. Cf. Baird 1983, p. 60: “(…) a general creditor (…) does not look to a particular piece of property to satisfy the debt. Even if he did, he could not effectively prevent the debtor from later encumbering or disposing of the property, because any promises that the debtor makes not to encumber the property are not enforceable against subsequent good faith purchasers.” In U.S. law, ‘purchasers’ is understood to include parties that take a security interest. See also Smith 1995, p. 718: “The filing system cannot possibly protect an unsecured creditor from having its claim ‘primed’ by a secured party, because the day after the unsecured creditor’s search is made, the debtor could grant a security interest and a filing could be made.”
27 Or credit rating agencies that consult the register on their behalf. See subsection 2.6 concerning this specific issue.
28 This argument has often been brought forward by audiences when I gave a presentation on the subject.
“(…) the filing system does provide other benefits by creating a means of public notice for transactions that the parties might want to publicize. Some debtors appear comfortable with financing statements in favor of their secured lenders, as a recorded means of assuring their suppliers that they have lines of credit to pay for the goods shipped.”

This is equally true if the debtor is in financial difficulties, but receives new money against security. There will undoubtedly also be cases, however, where a lender is about to ‘pull the plug’ and is reinforcing its security package without providing new money. The credit line may be terminated at a time that is convenient for the lender but not for the trade creditors. Hence, the pledging of the debtor’s assets in itself is not informative.

It is my view that to the extent that trade creditors choose to enter into the relationship without stipulating security, this is because what interests them is the cash flow from which they should expect to be paid, not the scope of existing security on the debtor’s assets. The fact that the debtor’s assets become pledged does not logically induce existing creditors to reconsider their sales conditions in relation to future supplies, simply because in isolation this does not provide information about (any decrease of) their debtor’s creditworthiness (or better put: its ability to pay its outstanding debts). It is for exactly the same reason that it cannot be true that potential trade creditors (should) feel inclined to stipulate security or would not enter into the relationship at all because the assets of the debtor have already been pledged. Consider Baird:

“(…) general creditors rely only in part on the debtor’s assets when extending credit. General creditors base their decision to lend on the debtor’s general financial health, of which a present or potential encumbrance on the debtor’s property is only one factor.

Cases in which general creditors decide to lend because of their mistaken belief that an asset is unencumbered are rare. A security interest should not greatly affect a general creditor’s assessment of the riskiness of his loan, because as a general creditor, he does not look to a particular piece of property to satisfy the debt.”

To conclude, in my view trade creditors enter into a business relationship on an unsecured basis, because they deliberately decide to do so, or because they were left no other choice by their buyers (i.e. the debtors). Not only is it in certain business sectors simply uncommon to stipulate for any form of security, the extent to which suppliers can do so also depends to a large degree on their bargaining power in relation to their buyers. It is not very likely that the introduction of a filing system will have an impact on both of these aspects.

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31 Baird 1983, p. 60.
When trade creditors do decide to stipulate some form of security, for example because it is common practice in their business sector or because the crisis sets in, public filing can in my view be useful for the reasons that will be discussed in subsection 4.1.2.

2.3. (Potential) lenders that decide to enter into a relationship on an unsecured basis

The assumption that potential creditors run the risk of entering into a (credit) relationship while they would have preferred not to, or to have done so under different (protective) conditions, such as taking collateral or asking for a higher price, is perhaps regarded as even more applicable to the debtor’s creditors that are potential lenders. In the discussion of the question which parties have an interest in publicity (or public filing), the emphasis is often placed on the providers of unsecured credit. The most noteworthy illustration of this can be found in the comments to Book IX DCFR:

“While a security provider may appear wealthy, persons intending to grant unsecured credit can access the register in order to obtain information as to whether assets held by the security provider would in fact be available to satisfy their claims in the event of the latter’s default or whether these assets are already encumbered in favor of other creditors.”

For the same reasons discussed in relation to trade creditors, it is not very likely that lenders will enter into the relationship on an unsecured basis because they assume that the assets are unencumbered and will remain so. Here too, such an assumption fails to recognize that in the interrelation between unsecured and secured creditors, it is not so much the date of origination of the debt that is relevant, but the moment in time that the security for such debt was taken. Moreover, insofar as one assumes that this information relates to the debtor’s creditworthiness, such legal information is ascribed a business-economic quality that it does not possess. In the previous chapter we saw that the debtor’s creditworthiness mainly depends on cash flow and other financial information with respect to the business (see Chapter 3, subsection 3.1).

Lenders commonly stipulate a surcharge precisely because they are aware of the risk of providing unsecured credit (see Chapter 3, subsection 3.1.2). Although they are obviously not entirely equivalent, this surcharge can be seen as an ‘alternative cover’ for a security right. In fact, rather than referring to a ‘surcharge’, it is perhaps better to use the term ‘discount’ when a debtor provides security, due to the mitigation of the risk of non-payment that this entails. Therefore, if lenders offer a ‘discount’ because they stipulate

32 The Atradius Payment Practices Barometer published in spring 2012 suggests that many Western-European businesses tend to increase their requests for secured forms of payment in times of crisis with the aim to protect their business from, e.g. payment defaults. Atradius Payment Practices barometer, International survey of B2B payment behavior, Core results Western-Europe (Spring 2012), p. 5.
33 Although ‘trade credit’ is also a form of credit, the provision of a loan by a bank is what first comes to mind in relation to the term ‘credit (provision)’.
34 Cf. DCFR (Full Edition) 2009, pp. 5495-5496.
collateral security, they will need to know for certain that they actually have the benefit of the collateral security they count on. As section 4 discusses, it is therefore only in this context – *i.e.* in the context where a lender has already decided to take a security right, *e.g.* because the segment is suitable for this) – that the question of whether the debtor’s assets are still “free” for recourse or for the creation of a first-ranking security is relevant.

After all, if it turns out that this lender was misled, for instance because there was an earlier secured lender that the debtor failed to mention, the lender concerned has become ends up in a lose-lose situation: not only does it have no collateral security to fall back on, it also settled for a discount, while the whole point of the ‘surcharge’ was to cover the loss of not being secured. 35

As a result, lenders that decide to enter into a credit relationship without stipulating collateral security, do so while – and because of – having the back-up of a stipulated surcharge; not because they believed their debtor was “credit worthy” enough to refrain from stipulating collateral security.

### 2.3.1. The main difference between trade creditors and lenders

Neither trade creditors nor lenders that conduct business with the debtor on an unsecured basis (and in case of lenders, consequently stipulate *e.g.* a higher surcharge due to the greater risk resulting from this choice), will benefit from public information on security rights, but we should be careful putting trade creditors and lenders on a par. If trade creditors decide to do business with the debtor or do so on an unsecured basis (and also do not stipulate a surcharge), they engage in this business relationship because their market position is just different from that of lenders.

Accordingly, the *nature of the relationship* of a debtor with trade creditors is very different from the relationship of a debtor with lenders. While a debtor enters into relationships with many trade creditors simultaneously, a debtor is usually served by only a few banks. Even when trade creditors conduct business with the debtor on a regular basis, the relationship will only last as long as the payment term, which by its nature is normally a relatively short period of time. By contrast, the relationships with lenders, usually providing most of the working capital (from which many trade creditors will be paid), will normally be of a much more protracted nature. As a consequence, lenders – both in terms of tenure and amount – run a concentrated risk on the debtor, while trade creditors only run the risk for their last (unpaid) supplies. The regulatory rules (Basel II and III) that lenders must comply with, as discussed in the previous chapter (subsection 3.1.2.1), include specific rules designed to limit these risks. These rules have a direct influence on the type and content of the credit that banks can provide. For instance,

35 Throughout this thesis these types of lenders are classified as ‘secured lenders’, because these lenders were misled in their deliberate decision to stipulate collateral security. A discussion of their position is found in section 4 of the Chapter.
unsecured credit results in a higher risk weighting, and a higher percentage of capital that must be held against it on the bank’s balance sheet, than secured credit. In an oversimplified form, one can say that a bank, when selling its products and services, needs to find a match with the customer that satisfies the profile associated with the product. This is in my view the main reason why a surcharge of this kind is only imposed by lenders: unlike lenders, trade creditors are not dependent on restrictions regarding the structure of their balance sheet. Whether trade creditors stipulate a security right or retention of title depends rather on whether this is common practice in the sector in which they operate or their bargaining power.

While a lender that has doubts about the debtor’s creditworthiness will simply not enter into the credit relationship at all or will ask for collateral when these doubts are minor, the trade creditor will not need to make the decision between asking for collateral or not supplying: it can demand cash payment against delivery. I bring into memory that in Dutch law this is actually standard practice if the supplier knows that the debtor is having payment difficulties (Cf. Chapter 3, subsection 3.2.4). It would not be logical for the supplier, having noted the presumed greater credit risk, to increase the price instead.

For this reason, it is not to be expected that trade creditors would have acted differently if publicity had been present, i.e. that they will act differently (‘more wisely’) if a public register is introduced. The same applies to lenders that decide to enter into a relationship on an unsecured basis (and stipulate a surcharge in their interest rate instead).

2.4. Interim conclusion
An interim conclusion can be drawn: publicity of existing security rights serves no useful purpose for either trade creditors or lenders that decide to enter into a relationship on an unsecured basis. Or put differently: they are not enticed into taking that unsecured status by the absence of such public information. In choosing an unsecured status, both trade creditors and lenders have opted for the risk that they could eventually rank below a prospective secured creditor; the one type of creditor (the trade creditor) takes that risk because it can fall back on asking for cash payment or because this practice is common in the industry or dictated by the buyer; the other type of creditor (the lender) – assuming it

36 This does not mean that banks would only be willing to lend on a secured basis; profit margin and product diversity are important considerations in this respect. See supra Chapter 3, subsection 3.1.2.
37 Cf. Baird in this respect: “(...) many creditors know before they even meet their debtor that they will lend, if at all, either on a secured or unsecured basis.” Baird 1983, p. 66.
39 Compare Livingston on unsecured lenders’ practice in the U.S.: “The unsecured creditors normally have already compensated themselves for their increased risk through higher interest rates and, in addition, usually do not search the public records before engaging in a transaction with the debtor. Because these creditors have not bargained for security and do not rely on the public notice filing system before lending, it makes no sense to penalize the secured party for mistakes in perfection.” Livingston 2007, p. 149.
is sensible – offsets that risk by stipulating a credit risk surcharge.\textsuperscript{40} In terms of risk-mitigating behavior, there is thus an essential difference between lenders and trade creditors; yet once they have opted for that unsecured status, there is no longer any difference whatsoever between them as regards their alleged need for publicity (whether or not made possible by means of a public register): because then neither of them needs it.\textsuperscript{31}

This therefore also applies for lenders that have asked the debtor for a security right but – for whatever reason – have not stipulated it. If they nevertheless enter into the trade relationship (under different conditions, but still) on an unsecured basis, then they can hardly complain if things go wrong. I reiterate that this differs from the situation of lenders that have become unsecured, because although they stipulated a (first-ranking) security right, it subsequently turned out that they did not obtain it (for instance, because it turned out that there was actually a first-in-time secured lender). These lenders were not misled in the (deliberate) decision to be unsecured, but were deceived in the (deliberate) decision to be secured. In this thesis they are referred to as ‘secured creditors’, and their fate will be discussed in section 4 of this chapter.

Keeping the aforementioned observations in mind, for the sake of clarity we must eliminate a common misconception. Whether or not the debtor has already granted security rights to a third party says nothing whatsoever about whether the debtor is ‘creditworthy’, that is to say: ‘worthy’ of being given credit (\textit{i.e.} capable of repaying it).\textsuperscript{42} An analysis of the debtor’s creditworthiness comprises a risk assessment in respect of every particular debtor’s financials. If a bank decides to lend against security, and the debtor \textit{is} able and willing to provide this, the basic premise from which the bank proceeds is to trust the debtor’s creditworthiness. (Collateral) security is (no more than) a safety cap for the situation where the debtor’s business fails to yield the profits to meet its obligations. This is illustrated by the fact that in jurisdictions where a public filing system is in place, such as the U.S., lenders do not postpone the decision about whether to supply credit – even with new customers – or about the terms under which they will do so, until after they have checked the register. This decision is made beforehand, and the register is only checked upon consummation of the transaction. This is because their decision to lend is based on other factors.\textsuperscript{43}

\textsuperscript{40} This will not only be the same credit \textit{under different conditions} (such as a higher price) but also a different \textit{kind of credit}. Although ‘credit’ is usually understood to refer to a specific amount of money, from the lender’s perspective the concept is decidedly more complicated. Because the conditions under which the credit is provided impact its balance sheet structure, the lender distinguishes different forms of credit. Thus for a lender, a loan of a specific amount against collateral is a fundamentally different (form of) credit than a loan of the same amount without collateral.

\textsuperscript{41} Also White argues that it is doubtful that general creditors such as the plumber or the carpenter check the files or collect data from the files through credit rating agencies. White 1995, p. 531.

\textsuperscript{42} \textit{Cf.} Baird 1983, p. 60.

\textsuperscript{43} This applies to new customers as well. The filing system merely offers the possibility to double check the information provided by the debtor. \textit{Cf.} Baird: “The need to check the files arises when the ’i’s have to be dotted and the ’t’s crossed. The information in the filing system primarily provides reassurance that all is as it appears to be and that
The outcome of negotiations on a loan between a lender and a debtor can naturally be that the loan will still not be provided, if the debtor does not accept or cannot fulfill the conditions under which the credit is granted (for example, because the debtor has a first lender, and refuses to grant its second lender a first ranked right of pledge). In that case, the existence of the first lender's security right has de facto the result that the second lender ultimately does not enter into the relationship with the debtor. My purpose in mentioning this is to emphasize that this is always the second step in the lending process. It is not the case that a lender's decision about whether to grant credit, or the specific conditions under which it will do this, is dependent in the first instance on whether or not the debtor has given security rights to another party.

As a consequence, while the decision whether to take security oneself (or to stipulate a surcharge instead) does bear a relationship with the presumed creditworthiness of the debtor concerned, it is not dictated by the fact that the debtor is known to have granted rights in its assets to a third party alone. In other words, whether or not the debtor's assets are free plays no part whatsoever in the creditor's desire to stipulate security.

2.5. (Existing) unsecured lenders that have stipulated negative pledge or pari passu clauses

A related question is how to view the position of unsecured lenders that stipulate so-called negative pledge or pari passu clauses with the debtor when providing a loan on an unsecured basis: would they be in need of publicity?

I reiterate from subsection 3.1.4 of Chapter 2, that negative pledge clauses have the purpose of prohibiting the debtor from creating a right of pledge in favor of another lender, as this would frustrate the first lender's right to take first ranking security itself or to recover its unpaid debt on a pari passu basis with other creditors. A pari passu clause

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44 That this order of priorities is clearly not unique to banks operating in the Netherlands follows from ‘Secured Transactions Systems and Collateral Registries’ (Washington DC: IFC, 2010), p. 15: “Though collateral is often described as secondary to character and capacity during the evaluation process, it very frequently influences the eventual approval of a credit application.” In this report in footnote 23, ‘character’ is defined as: “(...) the willingness of a company to repay based on past credit repayment history of the business and the principal business owners together with an analysis of business and personal stability (e.g. length of time in business, length of time at residence, etc.).”

Footnote 24 defines ‘capacity’ as follows: “(...) the analysis of the enterprise’s capacity to repay the loan. Qualitative indicators include an evaluation of management capacity whereas quantitative indicators include inventory turnover, profitability, cash flow analysis, debt service coverage ratios, etc.”
 requires the debtor to grant the first lender a security right of the same kind and ranking as was granted to the competing lender. The negative pledge clause also helps to better protect the secured lenders interests in the secured assets and avoids conflicts and complications if a prospective lender took second ranking security which it enforced against upon the occurrence of a payment default prior to the first lender’s loan having matured or defaulted.

Could it perhaps be argued that these lenders, without publicity, were motivated to enter into the relationship on an unsecured basis because – in view of these clauses – since they can count on obtaining the required security when it is needed, i.e. if the debtor enters into a secured loan with another lender? Given that the negative pledge and pari passu clauses apply to security rights to be created by the debtor in the future, in my view, little can actually be expected of publicity in this type of situation. Despite the fact that the debtor is prohibited from granting collateral security to another lender (or is required to grant the first lender a security right of the same kind and ranking as was granted to the competing lender), these clauses are no more than contractual obligations, which can be violated.

Hence, if this situation occurs, these unsecured lenders are also not missing out on protection due to the absence of publicity, not even if this information were available in a register that could be checked on a daily basis. After all, if the debtor indeed violates a negative pledge or pari passu clause, any check of the filing system will always be after the fact. The results presented in the interim conclusion can therefore be upheld.

2.6. Concluding remarks concerning the relevance of publicity for unsecured creditors

The aforementioned arguments prove that it is not to be expected that creditors that have willingly entered into a relationship on an unsecured basis will act differently (‘more wisely’), or end up in a better position, if a public register is introduced. This applies to both trade creditors and lenders that decide to enter into a relationship on an unsecured basis.

45 See e.g. Beekhoven van den Bozem & Goosmann 2010b, p. 47.
46 Cf. Comment A to IX. – 2:104 (DCFR): “Even though the owner may become liable towards the creditor for non-performance of the obligation, such a negative pledge clause does not prevent the creation of a security right, i.e. a secured creditor may obtain a proprietary right even if the security provider had promised to another creditor not to create such an encumbrance.”
47 If a debtor is not honest about the fact that it has already given security to an earlier lender, and this is why the lender enters into the relationship on this (unsecured) basis, the situation is somewhat different. After all, if this lender had known about the existence of earlier secured lenders, it would perhaps not have entered into the loan at all, or would have done so under different conditions. Because this type of deceit corresponds with deceit toward third parties that – instead of or in addition to a negative pledge clause – do indeed stipulate security, see section 4 for additional information. Cf. Leebron 1991, p. 1646: “A persuasive theory of secured credit financing has been elusive, but the priority of a secured creditor over other financial creditors can be justified on the grounds that non-secured creditors grant a loan knowing that some assets are subject to security interests or could be subjected to security interests without their permission. If particular creditors will not tolerate other creditors having security interests in the borrower’s assets, they can refuse to make a loan or make it only if the borrower agrees not to subject its assets to any security interests.”
There are then three additional related topics worth addressing. These topics touch on the question of whether there are perhaps parties whose interests are derived from unsecured creditors that might call for publicity or a public filing system. The first point worth mentioning in this respect is that it has often been argued that although unsecured creditors do not themselves consult the register, their credit rating agencies or credit insurers do:

“Credit reference agencies, in particular, may be seen as substitutes for unsecured creditors in the examination of a company charges register.”

The fact that trade creditors do not in practice take the trouble to consult the register does not mean that this interest does not exist, so the argument often runs. Referring back to previous arguments found above, my comments can be brief: to the extent that unsecured creditors do not take the trouble to consult the register, the explanation is simply that they can deduce very little from information about the extent of encumbrances (except that it forms part of the overall picture of a business). That this information can be obtained through credit rating agencies and credit insurance companies does not alter this observation.

Second, the question is sometimes raised as to whether or not precisely non-contractual unsecured creditors, such as victims of tort or unjust enrichment, would have an interest in public information, since they – unlike contractual unsecured creditors – have not chosen their own fate:

“Some creditors may prefer unsecured status because they are compensated by receiving a higher rate of interest. (...) Others, such as the victim of a car accident or an employee with an action for wrongful discharge, do not choose the role of unsecured creditor; they are thrown into it without the opportunity to negotiate.”

The answer is obviously negative: tort victims did not rely on anything to begin with. Unlike prospective pledgees or buyers, their actions were not based in any way on public information of security rights.

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48 Bridge 2008, p. 186. Cf. ‘Company Security Interests’ (London: The Law Commission, 2005), p. 51: “We agree that unsecured creditors may seldom (consult the register, DJFH) but we understand that the register of company charges is consulted by credit rating agencies and others on whose information unsecured creditors rely (...)” and Simkovic 2009, p. 261: “(...) U.C.C. filings are a critical source of information for creditors because they are incorporated into credit reports and ratings by private agencies such as Dun and Bradstreet and Experian.” See also e.g. Mooney 1988, p. 762 et seq.

49 LoPucki & Warren 2012, p. 23. Dutch author W. Snijders also makes use of this argument; see Snijders 1995, p. 34. See on this subject Leehron 1991, p. 1647-1648.

50 Cf. Harris & Mooney 1994, p. 2059: “Because tort victims do not choose their tort-feasors (at least not in any meaningful way), whether a security interest is disclosed in the public record (or otherwise) seems irrelevant to that class of creditors.” I agree with Harris & Mooney, however, that public information on security rights may have relevance to tort creditors after all when they have obtained “judgments against the debtor and seek to determine
A third and last question that is sometimes raised is whether public information on existing security rights could perhaps prevent unsecured creditors incurring unnecessary attachment costs, by warning them about the existence of encumbrances on the assets concerned, which may render these assets worthless from a perspective of recovery. In my view, this is not entirely without merit. Although attachment also serves the purpose of putting the debtor under pressure, it cannot be ignored that when unsecured creditors attempt to seize the assets to recover their claims, they may be disappointed when the assets turn out to have been pledged. Given that from the time of attachment both enforcing unsecured creditors and the secured lender claim the assets concerned, a semi-‘proprietary conflict’ arises and who will win depends on political choice. The basis of this conflict, however, is different than in respect of secured creditors: attaching unsecured creditors do not become involved in a proprietary conflict because the debtor misinformed them, but because they had no other choice than to give it a try. This does not alter the fact that the lack of publicity prevents those creditors from avoiding unnecessary attachment costs, given that they are not warned about the fact that these assets are worthless from the perspective of recovery. From this perspective, unsecured creditors could benefit from public information on whether security interests exist.

3. The genuine interest of unsecured (trade) creditors and effective ways to protect them

In assuming that publicity is useful to the position of unsecured creditors, it seems to me that attempts are sometimes made to ‘put right’ the position of trade creditors and other general unsecured creditors, who all too often (rightly or wrongly) are seen as pitiable, by seeking the solution in (providing more) public information on security rights. There would seem to be a broadly felt sympathy for the position of unsecured creditors (in or
outside bankruptcy), because they are mostly left empty-handed and – unlike prospective buyers and pledgees – are not in any way protected, while at the same time they might not have known that certain movable assets were encumbered with a security right.\footnote{This might also be because in secured transactions law – which turns into bankruptcy law if the debtor goes into default – the question of what secured creditors receive and what remains for distribution among unsecured creditors is a frequently debated issue. It mostly boils down to the conflict between secured lenders and the general unsecured creditors (who are mostly suppliers of goods or services). In practice, unsecured trade creditors usually receive no more than a few percent of their claims. See e.g. Hamwijk 2006.}

“A creditor’s right of recourse can turn out to be worthless as a result of the security rights created by the debtor in favor of other creditors. If publicity is linked to security rights, the consequence is that the other creditors of the debtor/pledger can be aware of the fact that, because of the security rights that have been created, there are few if any unencumbered assets available for them. The consequences of security rights could, in a certain sense, become justified because the other creditors were able to find out about them before proceeding to grant credit."\footnote{Van den Heuvel 2004, p. 88 (translated). For the sake of completeness, I note that Van den Heuvel also takes a critical stance as regards this view (correctly in my opinion), by asking whether making security rights public sufficiently protects the interests of these creditors.}

The most striking, and often cited quote in this respect is from LoPucki who describes security as ‘a contract between A and B that C take nothing’.\footnote{LoPucki 1994, p. 1899.} It seems that information is seen as the answer to a question that relates not to publicity, but to policy: why is it justified that there are security rights in the first place that give certain creditors (mostly lenders) priority over others? The assumption in this reasoning appears to be that the priority brought about by a security right can be justified only if all the third parties against which the security right has effect are able to know about it:

“Da die dinglichen Rechte als absolute Rechte gegenüber jedermann wirken und von jedem Dritten zu respektieren sein, müssen sie auch für jedermann erkennbar sein.”\footnote{Hamwijk 2006.}

Or, in the same line of thought, that as a normative matter the benefits of a security interest should not be easily obtained in order for it to be justified against the debtor’s unsecured creditors. See in this respect Harris & Mooney, who in discussing the Art. 9 UCC filing rules speak of “a hurdle that a secured party must clear in order to justify its entitlement to collateral at the expense of a debtor’s unsecured creditors”.\footnote{Harris & Mooney 2006, p. 160. It is at least illustrative to note that one of the comparative studies conducted under the umbrella of the ‘Common Core of European Private Law’ project was called ‘Conflicts among secured and unsecured creditors in relation to movable assets’. This project is also known as the ‘Trento project’, since the study was undertaken at the Law Department of the University of Trento, Italy. For more information see <www.common-core.org/> (last visited February 5, 2014) and Simpson & Menze 2000, p. 43.} A similar attitude was expressed early in the process of drafting Article 9 UCC, just before the notice filing system was
introduced. The reporters proposed to give secured creditors the duty to make sure that the debtor’s financial records made full disclosure of any security interest. Creditors and buyers misled by this failure had the right to recover any loss caused by their good faith reliance, not only against the issuer of the statement but also against the secured creditor ‘who had failed to perform his policing duty’.\textsuperscript{58} The proposal never made it to law because, in Gilmore’s words, ‘the Reporters were unable to convince anyone of the soundness of their position’.\textsuperscript{59}

As explained above, however, publicity of security rights is of not much relevance to an unsecured creditor (which in practice, is usually a trade creditor).\textsuperscript{60} Yet if creditors do not want to be disappointed in their ability to take recourse, they will have to stipulate a pledge or retention of title, no matter how wealthy or creditworthy the debtor may appear to be:

\begin{quote}
“Perhaps that absence of notification to unsecured creditors should not concern us as much as the plight of the secured party because the former have freely chosen their inferior class.”\textsuperscript{61}
\end{quote}

It is true, of course, that trade creditors are not always in a position to impose their business terms, e.g. to stipulate security, but the presence of a public notice filing system does not change this. Likewise and just for the sake of clarity, a public register is of no relevance to trade creditors who supply goods and who choose to take a security right or stipulate a retention of title over the goods so supplied, i.e. secured trade creditors. There is no question of any risk that the debtor is dishonest with regard to the legal status of such assets, because those assets do not (yet) belong to the debtor’s estate and trade suppliers can simply transfer those assets subject to retention of title or subject to the retention of a right of pledge.\textsuperscript{62} Since the debtor does not actually grant these to its supplying trade creditor(s), the debtor cannot be guilty of deceiving these creditors either.\textsuperscript{63}

There is a nuance to this. Secured trade creditors run the risk of losing their entitlement when the secured assets that they supplied become the debtor’s property if, for example

\begin{itemize}
\item \textsuperscript{58} Gilmore 1 1965, p. 464.
\item \textsuperscript{59} Gilmore 1 1965, p. 464.
\item \textsuperscript{60} This does not apply to unsecured creditors attempting to seize the debtor’s assets; see supra subsection 2.6.
\item \textsuperscript{61} See Philips 1979, p. 12. However, he continues: “The equitable basis of according priority to the perfected secured party, however, depends not only upon the unsecured creditors’ lack of action, but also upon their ability to assess accurately the consequences of belonging to the class they have chosen.” I agree with him on this nuance.
\item \textsuperscript{62} For Dutch law; see Art. 3:92 BW for retention of title and Art. 3:81(1) BW for right of pledge. The latter enables an owner of an asset to transfer such asset subject to a right of pledge retained by that owner; accordingly, the transferee does not acquire its right of pledge from its successor and never depended on its authority to create such pledge, but will simply have ‘retained’ it from the outset.
\item \textsuperscript{63} It is important for secured sellers, of course, that they do not lose their retained title as a result of a disposition by the debtor. This will be discussed in subsection 4.1 of this chapter.
\end{itemize}
they become part of a newly formed asset that the debtor has created (accession). Rights of pledge on all of the debtor existing and future assets as commonly stipulated by lenders will take priority and accordingly the supplier will at best only be second in line or in the worst case will have lost its security altogether. Only if the supplier had stipulated a right over the newly formed asset earlier in time than a competing secured lender, it would have priority over the latter. This will make that supplier a secured trade creditor whose position will be discussed in subsection 4.1.1.

3.1. Effective ways to protect unsecured (trade) creditors

It is my view that those who believe unsecured creditors benefit from publicity (or public filing), as a means to inform them about the deteriorating financial position of the debtor resulting from further encumbrances, are wrong. Unsecured (trade) creditors do not need a warning that the pool of unencumbered assets is decreasing as such, because such a decrease in itself, without understanding the reason and context, will be meaningless to them. As discussed in subsection 2.2 above, creditworthiness cannot be deduced from information about the (decrease in) quantity of unencumbered assets. This is also true for the risk of bankruptcy, which after all is just an extreme manifestation of (non-) creditworthiness. So, whilst arguably for example unsecured trade creditors may benefit from early warning systems so that they know when it is no longer wise to continue supplying goods on credit terms (without additional protective conditions), precisely because assets or encumbrances in themselves are incapable of informing, publicity or filing systems are simply not the suitable agent to convey early warning signals.

If one really wants to come to the assistance of unsecured (trade) creditors – in my view an honorable cause – one should think of something other than providing public information on security rights. The very existence of security rights (or their preferential position) could be re-examined, or unsecured creditors could be compensated in other ways, for example by means of a 20% rule, in existence in the United Kingdom or

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64 Asser/Van Mierlo & Van Velten 3-VI* 2010/539. Cf. Kieninger 2004a, p. 381. Compare HR 3 February 2012, LfN BT6947 (Dix q.q./ING Bank) and Verstijlen 2012 on this subject.

65 Even if a trade creditor regularly does business with the debtor, the relationship with the debtor as regards each supply will only last as long as the payment term. ‘Continuing to supply’ therefore amounts de facto to entering into a new commercial relationship each time.

66 In this respect, Philips argued for U.S. law, that to protect unsecured creditors, more information should be included in the public filing system, because information about whether assets are encumbered or not says nothing about the business’s creditworthiness. See Philips 1979.

67 Contrast Harris & Mooney: “Unsecured creditors sometimes may be interested in whether there are filings against a debtor for other reasons however. For debtors in some lines of business a filing against receivables or inventory may be seen by trade creditors as a signal of financial distress whereas a filing against equipment would be viewed differently.” Harris & Mooney 2006, p. 159.


70 This is a complex rule – often referred to as Carve-out – that in essence entails that the unsecured creditors can receive a proportion of the proceeds from a floating charge. In theory, this proportion is 20%, but in practice it often turns out lower or is even not paid at all, because (application of) the rule is subject to many exceptions. For more detailed information, see Art. 176A of the Insolvency Act 1986 (as amended...
Chapter 4

Sweden.\(^{71}\) This also applies to the perceived problem that lenders often have a security right on all of the debtor’s assets, which translates into the problem that in the event of bankruptcy there is nothing left for the unsecured creditors after distribution of assets. In addition, it could compensate trade creditors for losing their retention of title or their stipulated rights of pledge on future goods, due to accession, commingling and the like.\(^{72}\) It is not my aim to argue in favor of any one of these alternatives. My only objective is to put forward the argument that perceived dissatisfaction as regards the position of unsecured creditors cannot in any event be solved by introducing a public filing system.\(^{73}\)

3.2. An alternative reading of the term ‘publicity’: objective information as a means to prevent fraud

There is in my view, however, another problem that could possibly be solved by publicity and which is important mainly to unsecured (trade) creditors. In other words, I believe that there is a need for a ‘notice’, \(i.e.\) for publicity in a very different context than the context described above, namely when attempts are made to decrease the assets by means of bogus proprietary transactions or manipulation of the precise moment in time at which proprietary transactions are said to have taken place. In the case of such fraud, creditors (both unsecured trade creditors and other unsecured or secured lenders) do not feel the adverse consequences of the bankruptcy itself – in \(a\) concursus the consequences of their unsecured position will naturally manifest themselves – but rather are harmed because the debtor’s estate is manipulated. In fact it is only faked that the available assets are reduced,


\(^{71}\) In Sweden, one type of security interest (the so-called ‘Företagsinteckning’; a security interest on all the assets of the debtor’s enterprise) is limited to 55\% of the value of the assets. This limitation is set in order to be sure that there are valuables left for unsecured creditors. See Reinertsen Konow 2006, p. 647. Other (also non-European) countries have also adopted Carve-out rules for several types of unsecured creditors; see LoPucki, Abraham & Delahaye 2013, p. 1857, footnote 346 for a brief overview and further references. For the Netherlands, see static.basenet.nl/cms/105928/website/brief-aan-minister.pdf.

\(^{72}\) Or for the risk they run that a security right created by anticipation for the benefit of a supplier over finished product ranks after an earlier security right created by anticipation by a bank, as is a considerable risk in Dutch law.

\(^{73}\) Another question is whether creditors should be facilitated in withdrawing their supplies, or imposing extra conditions on them, in the twilight zone before bankruptcy; at least, if this is based on an unreliable signal (‘encumbrance of the debtor’s assets with a security right’). See in this sense also Lwowski 2008, pp. 214-222. In my view, this depends entirely on the reorganization culture of a certain jurisdiction. It would provide an additional argument for introducing something akin to the 20\% rule.
but the distinction from actual reduction of the available assets appears to be very thin if security rights can be created with few if any formal requirements.

In Dutch law it was Professor Meijers who, when working on Dutch New Civil Code and a proposal for the introduction of a non-possessor pledge, drew attention to the problem of antedating or making false deeds (of pledge) to the detriment of general creditors. Meijers had argued against the recognition of the fiduciary transfer back in 1929, primarily because it was ‘not sufficiently public’. After looking more closely, it seems to me that he particularly objected to the fact that fiduciary transfers (without registration) opened up the possibility of malpractice in the form of making false deeds that could be enforced against creditors seeking attachment (general creditors).74

It is important for (all) unsecured creditors, or for a bankruptcy trustee acting on their behalf, to prevent these manipulations to the greatest extent possible. One could say that the introduction of a non-possessor security right takes away the ‘objectively determinable moment’ – a notice, or ‘warning’ – at which the asset is handed over from the debtor to its lender, and thus makes room for such manipulation: if the moment of handover depends purely on what the debtor and secured lender agree in their contract, this is difficult to justify in relation to third parties because of the risk of fraud of that date.75 This risk can be counteracted by requiring that the security right is filed in a public register from the moment of its creation.76 However, strictly speaking, this does not have to be public; it just needs to be verifiable.77 After all, the point is to reveal transactions that have been manipulated. For this it is necessary, but also sufficient, that the moment of the manipulated transaction can in some way be found, i.e. determined with certainty. Objectivity regarding the moment at which already completed (and not necessarily disputed as to their validity) legal acts have taken place can be accomplished by making this moment verifiable:

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74 Meijers 1936, p. 184.

75 Seen from this perspective, it was the change in possession that ‘made public’ the creation of a security right, not possession itself. In this respect, some authors do indeed – consciously or not – refer to the ‘change in possession’ rather than to ‘possession’ (by one or the other) itself. See also Spanogle 2009, p. 284.

76 Compare Comment B to IX. – 3:301 (DCFR): “The registration could (...) serve as a means of proof of the time at from which the security is effective. (...) It also works as between the secured creditor and a security provider who attempts to obstruct execution against its assets by the secured creditor by claiming that the assets concerned are actually subject to an earlier security right created in favor of another creditor (who participates in the security provider’s fraudulent conduct). A requirement of publicity by registration could give protection against the backdating of a security.”

77 Compare Anderson expressing a critical view on the Scottish law reform process: “Although I think that a Register of Moveable Transactions is unnecessary, I acknowledge that registration is one way of achieving certainty and publicity. My own view, however, is that the date of (notarial) execution of a security document is more in line with commercial expectations.” Anderson 2012, p. 271.
“In order to have a right that is enforceable against third parties and to determine the ranking with competing entitlements, it is sufficient that there is a fixed point in time that allows, without discussion, to establish the creation of a security right.”

In Dutch law, this is achieved by requiring a non-possessory pledge in movable assets and claims to be created by a notarial deed, or by a private deed that is registered with the tax authorities and is not open to public inspection (see supra subsections 2.2.3-2.2.4 of Chapter 3). The purpose of this action is to ensure date certainty. German law, having no such filing requirements, no means are provided at all to ensure date certainty.

Manipulation of this kind, i.e. the risk of antedating, should in my view be sharply distinguished from the transactions that are counteracted (in the Netherlands) by the actio Pauliana, a remedy available to bankruptcy trustees to avoid transactions that would be detrimental to the general body of creditors. While the first case concerns manipulation of legal acts or legal moments, the actio Pauliana concerns violation of the paritas creditorum rule by legal acts that are in fact known to have taken place prior to bankruptcy, but have prejudiced the general body of creditors. The problem of malpractice of the debtor and secured lender immediately prior to bankruptcy, by the withdrawal of assets at the expense of the other creditors, is sometimes lumped together with the problem of ‘secret liens’, i.e. the publicity subject. One of the authors who wrote about the doctrine of publicity and drew attention to this risk is the American author Lipson. In the discussion of the secret lien problem he cites the 1973 Report of the Commission on Bankruptcy, a report that ultimately led to the American Bankruptcy Code: “One of the essential features of any bankruptcy law is the inclusion of provisions designed to invalidate secret transfers made by the bankrupt prior to the date of filing of petition.” Although the term ‘secret transfer’ might make it seem that this is a problem caused by the lack of publicity (i.e. a ‘secret lien’ problem), in my view it must be emphasized that they are two clearly distinct problems, being two very different forms of deceit: the ‘deceit’ that a debtor practices by pledging an asset twice (e.g. in order to obtain two loans, or under more favorable conditions) with no question as yet of imminent bankruptcy is very different in nature than the deceit that a debtor practices by transferring its assets to friendly parties while it knows that bankruptcy is approaching.

80 In Dutch legal practice the transactions that are contested by means of actio Pauliana are much more important than the risk of antedating. The main concern is hardly ever to pinpoint the moment at which a transaction took place; much more often the issue is whether the transaction was still permitted at a particular moment in time.

81 See for example Simkovic 2009, p. 258: “Secret lien doctrine continues today as the ‘strong-arm power’ in § 544(a)(1) of the Bankruptcy Code—the power of the bankruptcy trustees to void secret transfers made prior to bankruptcy.” See Anderson 2012, p. 268 for recent commentary on this subject.

in the latter case, it potentially disadvantages not just one single existing lender (e.g. the secured lender that believes it is first in line) – and after all, it is far from certain that the prospective secured lender will really not be repaid – but all creditors of the bankrupt estate. Moreover, in the latter case a very different (more malicious) motive is involved, precisely because the debtor knows that it will end up bankrupt.83

4. Secured creditors

4.1. Introduction

4.1.1. Second-in-time lenders and trade creditors that decide to enter into a relationship on a secured basis

We now turn to the fate of creditors that choose to enter into a relationship on a secured basis.84 While we established in section 2 that the absence of public information on existing security rights does not put unsecured creditors in a worse position than if that information had been available, it was briefly mentioned in subsection 2.3 that this differs from the situation of lenders that do opt to take collateral security.

I repeat again that this decision – the decision to stipulate security – is not dictated by the fact that the debtor has already given security rights to a third party, but by an estimation of its actual creditworthiness and other considerations; for this, see subsection 2.4.

If a lender requires a first ranking right of pledge for its credit exposure but this turns out to have already been given to another (i.e. earlier) lender,85 the former will miss out, unless it is granted good faith protection by law. This equally applies to the (quite exceptional) case that secured trade creditors stipulate a right of pledge on newly formed assets that the debtor has created (accession). Only if the trade creditor stipulates this security right over the newly formed asset earlier in time than a competing secured lender, it will have priority over the latter. Since such creditors, unlike unsecured creditors, have deliberately taken action to avoid the risk of being left unsecured, they run the risk that – apart from the possibility of invoking third party protection – their ‘risk-mitigating action’ will be nullified.86 Therefore, and by contrast to unsecured creditors, in this context one can indeed speak of a “false impression” or a “false appearance”; after all, the debtor is not

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83 In my view, it is not really surprising that at the time when a non-possessory form of security was introduced, the risk of fraudulent transfers was regarded as greater than in the situation before its introduction: after all, when the transfer of possession was still a requirement in the creation of security, one had to physically move the asset to the secured lender if one wanted to make a fraudulent transfer; it was possible – the idea was – to see that malpractice, and the creditors could therefore prevent or reverse it, at least in theory. After the introduction of non-possessory security, the bankruptcy trustee could arrive at the bankrupt estate and find that everything had already been pledged, without having had the possibility of noticing it.

84 See supra footnote 35 of this chapter.

85 Or its right of pledge turns out to be not (yet) in existence at all, because a seller has stipulated retention of title on the assets. See supra Chapter 3, subsection 2.4.4.1.

86 In other words, they will have no security at all, or they will have the benefit of a security interest with a lower ranking than expected.
simply trading its assets, it is offering them as collateral in disregard of the earlier encumbrance.

In my view, it was for this reason that, when most national laws in Europe only provided for a form of possessory pledge, back in the 19th century – with the introduction of the Civil Codes – the collateral had to be handed over to the lender: “(…) to make it more difficult for the debtor to dispose of the pledged goods to a third person (…)”\(^8^9\) see supra Chapter 2; subsection 5.1.

In Chapter 3 it has been discussed that in Dutch law, second-in-time pledgees will only be protected if their security right is possessory in nature and only if they have acted in good faith with regard to a first-in-time pledge when the goods are brought into their possession (Art. 3:238(2) BW).\(^8^8\) However, possessory pledges are not used very often in commercial practice. The consequence of the absence of public information on who holds a security interest is therefore that these secured parties, can be confronted with an earlier existing security right, without being protected from this unanticipated situation.\(^8^9\) For lenders, this means that they runs the risk of ending up with a security right of a different ranking than anticipated when entering into the loan agreement, while at the same time not having stipulated a surcharge, and thus is not covered to the extent it assumed. A similar situation occurs when a lender stipulates a security right on assets that turn out to be not (yet) owned by the debtor, because they were subject to a retention of title clause. In this context, the second-in-time lender will not become a pledgee at all, unless it obtains a possessory pledge and acts in good faith regarding the fact that the debtor was not the owner at the time it granted the lender the right of pledge (Art. 3:238(1) BW).\(^9^0\)

For the same reasons as mentioned in relation to secured lenders among themselves, this rule does not apply very often in practice: lenders rarely take possession of the assets that are subject to retention of title, given the nature of these assets.\(^9^1\)

4.1.2. First-in-time secured lenders and selling secured trade creditors

The fact that third party protection rules may be applicable means that the absence of public information on security rights also creates a risk for the existing secured creditors, i.e.

\(^{8^7}\) Drobnig 2011, p. 1027.

\(^{8^8}\) Or, this passes into the possession of a third party. Art. 3:238(2) BW makes clear that the moment of establishing good faith is crucial for deserving protection: if the second-in-time pledgee acts in good faith at the moment of creation, but is no longer in good faith at the moment the goods are brought into its possession, it will not deserve to be protected. See supra Chapter 3, subsection 2.4.3.

\(^{8^9}\) The same applies to secured trade creditors that have stipulated a right of pledge on newly formed assets; the debtor can make these suppliers believe that its lender does not have the benefit of a security right on future (newly formed) assets.

\(^{9^0}\) As a result of this protection, the seller’s retention of title terminates and the pledgee acquires a right of pledge; see supra Chapter 3; subsection 2.4.4.1.

\(^{9^1}\) For the same reasons as mentioned in subsection 2.4.3 of Chapter 3, the rule may after all apply when the ‘bodemverhuurconstructie’ is used and the pledge becomes possessory in nature.
first-in-time secured lenders and first-in-time secured sellers: namely, the risk that a prospective lender will be protected at the expense of their own claim on the asset. If a lender takes a possessory pledge and acts in good faith with regard to a first-in-time secured lender when the goods are brought into the formers possession, the first-in-time secured lender or seller will rank second (see Art. 3:238(2) BW). If existing secured sellers have retained ownership in the assets, they run a similar risk, the only difference being that in the same circumstances, they run the risk of losing title to the assets sold; see Art. 3:238(1) BW).

First-in-time secured lenders and secured selling trade creditors run these risks not only in relation to prospective lenders, but also in relation to prospective buyers, to whom goods that have already been pledged or are subject to retention of title can be (re-)sold, while not being authorized to do so. If a debtor has not been authorized by its secured lender or seller to sell the collateral in the ordinary course of business, or if the debtor sells other assets (that do not have this purpose), the buyer will only acquire unencumbered ownership of the asset if it deserves protection on the basis of Art. 3:86(2) BW in the case of retention of title, or Art. 3:86(1) BW if the goods are subject to a right of pledge. I reiterate that, in a nutshell, both paragraphs of Article 3:86 BW require that the buyer acted in good faith, paid for the assets and received physical delivery of them.

4.2. Interim conclusion

Depending on the perspective from which one views a transaction conducted by the debtor (‘B’), the absence of public information in a system of non-public filing can thus lead to loss, in two ways: entitled parties – the ‘A’s’ – can lose their already established proprietary interest to prospective bona fide buyers and pledgees – the ‘C’s’ – while at the same time these ‘C’s’ run the risk of falling outside these third party protection rules (and therefore not obtaining the right or ranking they stipulated). Hence, the absence of public information results in all these cases in a conflict of interests between A and C. Depending on which interest has greater weight in this conflict, one of the two will
ultimately be protected, and the other will lose out. A legislature in a non-public filing system is logically forced to make a choice: which party should win?

There has been written quite a lot about the conflict of interests that arises if a debtor without being authorized to do so transfers or pledges the asset to a third party that acts in good faith, and different European jurisdictions have chosen different solutions for this conflict.\footnote{On this conflict in the case of an authorized sale by the debtor, see e.g. Salomons 2007.} The design of third party protection rules is purely a matter of political choices, whether or not based on economic considerations: must C take possession of the assets? Must it act in good faith? When is it acting in good faith?

The purpose served by public information on existing property rights seems to be clear: without information on the true entitled party, at least one of the two parties will be victimized. Because prevention of such conflicts seems better than having to resolve them, it seems useful to provide publicity about who has the benefit of a proprietary (security) right.\footnote{Whether this publicity should be realized at any price, e.g. by introducing a public register, will be addressed in Part III of this thesis.} That the main purpose of publicity is to publicize security rights for this reason – i.e. so that prospective third parties can verify the existence of security rights, and ‘proprietary conflicts’ are thus prevented – is a standard view to be found in many Dutch, (Western and Eastern) European, Asian and U.S. sources on the subject of publicity. To quote just one example of these many sources:

“The need for publicity derives from the desire to avoid the problems that arise when one person who has, or wishes to acquire, rights in an asset is not able to ascertain what rights others may have in the same asset.”\footnote{‘Publicity of Security Rights: setting standards for charges registries’ (London: EBRD, 2005), p. 22. To be found at: <www.ebrd.com/pages/sector/legal/secured/core/guidingprinciples.shtml> (last visited February 5, 2014).}

Presumably precisely because of the existence of third party protection rules, several, tend to focus on the interests of existing secured parties, i.e. first-in-time lenders and sellers scholars, in discussing the use of a filing system. Publicity would not so much be intended to protect the ‘third parties’ – the second-in-time parties that are misled by the debtor\footnote{See in this respect e.g. ‘Publicity of Security Rights: setting standards for charges registries’ (London: EBRD, 2005), p. 22: “Publicity also enables the creditor to ascertain existing charges affecting charged assets.”} – but rather entitled, i.e. first-in-time parties, because it gives them the possibility of publicizing their right. This would prevent them from losing their right to prospective bona fide ‘third parties’.\footnote{See for example Comment B to IX. – 3:301 (DCFR): “The secured creditor also benefits from registration of its security rights. Publicity by registration gives notice to third parties of the existence of the encumbrance or retention of ownership devise in the secured creditor’s favour. Third persons can then be regarded as having actual or constructive notice preventing them from acquiring the collateral free of the original secured creditor’s rights on the basis of good faith acquisition.” Cf. Jackson & Kronman 1979, p. 1143: “To a considerable extent, the value of a security interest depends upon the degree to which it insulates the secured party from the claims of the debtor’s other creditors.”} Tailored to the position of the lenders and sellers, the main
focuses of this research, this then relates to the possibility of prospective lenders and buyers\textsuperscript{104} that will have the ability to verify the existence of earlier established security rights, so that the rights of the first-in-time lenders and sellers remain intact. For lenders:

\"The filing system is a means for a secured creditor who takes a non-possessor security interest in property of a debtor to communicate the existence of that security interest to others who may later consider extending credit to that debtor.\"\textsuperscript{105}

If we look more closely, we see that the purpose served by public information actually amounts to the mitigation of the risk that the debtor through its behavior (deliberately or not) causes lenders and buyers to believe that the assets are unencumbered when they intend to obtain a security right or to buy the asset. After all, it is not evident that (either existing or future) secured creditors run the risk of being confronted with earlier rights: surely one can simply ask the debtor whether it has already given security rights to an earlier lender or seller? White, for example, puts forward the following question in relation to secured lenders operating in the U.S.:

\"But what reliance do these filers place in the filing system? And more to the point, how would they behave in the absence of a filing system? Any creditor that is to be the principal inventory, equipment, or account receivable lender to a substantial mercantile enterprise will have many sources of information about the prospective borrower; the filing system is unlikely to be the most important source. The debtor and the debtor's records are obvious sources of information.\"\textsuperscript{106}

The literature on this viewpoint seems to reveal that the perceived problem, when there is no public filing system to check, seems to be that lenders have to rely on the debtor when obtaining security for their claim.\textsuperscript{107} For the most part, this seems to boil down on a felt risk of deceit committed by the debtor regarding whether someone has an earlier claim on its assets:

\"But because of the possibility of debtor misbehavior, it is undesirable to rely on the debtor for information about claims to his own assets.\"\textsuperscript{108}

\textsuperscript{104} And in exceptional cases subsequent secured trade creditors, namely when they stipulate a right of pledge on newly formed assets that the debtor has created (accession). Only if the trade creditor stipulates this security right over the newly formed asset earlier in time than a competing secured lender, it will have priority over the latter; see section 3 and subsection 4.1.1.

\textsuperscript{105} LoPucki & Warren 2009, p. 404.

\textsuperscript{106} White 1995, p. 531. \textit{Cf.} Livingston 2007, p. 163: \textit{\textquotedblleft In the best of all possible worlds, the information-seeking party would simply ask the debtor whether there were any prior security interests in particular collateral, and the debtor would respond truthfully and accurately that there were or were not.\textquotedblright}"

\textsuperscript{107} The supra footnote 109.

\textsuperscript{108} Baird & Jackson 1982, p. 179. \textit{Cf.} Simkovic 2009, p. 290: \textit{\textquotedblleft They would not need to rely on disclosures from debtors, who are by definition conflicted and might also be mistaken.\textquotedblright} See also Comment B to IX. – 3:319 (DCFR): \textit{\textquotedblleft Any prospective creditor or other interested party might as a matter of course also inquire from the security provider whether certain assets are encumbered with a security right or subject to a retention of ownership device or not. However, especially if...\textquotedblright}
In addition, there would be the risk of “undeliberate deceit”, *i.e.* of simple mistakes made by the debtor as to whether its assets have been pledged at all, or – in more complex transactions – which ones.\(^\text{109}\) In other words, an objective source is called for: if a lender (for whatever reason) decides that it wants to enter into the trade relationship with a certain debtor *on a secured basis*, this lender wants to ascertain that it actually *has* that security right or that ranking with respect to particular collateral and that it will be granted the legal position it is promised.\(^\text{110}\)

4.3. Further analysis & critical remarks

4.3.1. Dutch lenders’ practice

In spite of the foregoing, neither the German nor the Dutch banking practice seems to see any advantage in a public filing system.\(^\text{111}\) In the Netherlands, this is mainly supported by the argument that publicity is already available in the form of the (most recent) annual financial statements and management letter that banks ask from their debtors, which are audited by an accountant.\(^\text{112}\) Anderson recently made a similar argument in the Scottish law reform process:

“(…) those most likely to use the register – sophisticated, professionally advised financiers – have limited need for the Register because it tells them what they already know. The information sophisticated parties really need is normally obtained during a due diligence process, by forcing the debtor to disclose copies of all security documents.”\(^\text{113}\)

\(^{109}\) Especially in light of the fact that generic bulk pledges are becoming increasingly popular, debtors may simply not be so aware (anymore) which of their assets have been pledged to their (first) lender or to what extent there is overlap. Likewise, in complex finance transactions the loan documents can be so complicated that the legal advisors concerned make errors, possibly due to the commercial pressure involved in making the transaction.

\(^{110}\) *Ibidem.* Cf. Beekhoven van den Boezem & Goosmann 2010a, p. 52.

\(^{111}\) See *e.g.* German author Lwowski 2008, p. 179: “(…) neither the German banking industry nor the business community see any benefit in a filing system for security interests.” In addition see supra the Chapter 1, subsection A.4.

\(^{112}\) Beekhoven van den Boezem & Goosmann 2010a, p. 753 and Beekhoven van den Boezem & Goosmann 2010b, pp. 44 and 53.

\(^{113}\) Anderson 2012, p. 269.
At first sight, these opponents seem to be jumping to conclusions. After all, the debtor’s (semi-annual) financial statements are little more than a reflection of what the debtor itself wants to make public. The same applies to the debtor’s declaration as to whether or not it has already pledged it assets (Art. 3:237(2) BW): this may easily be a false statement.¹¹⁴

When we consider the findings of the previous chapter, however, we see why aforementioned authors nevertheless have a point, in terms of the limited risks of these problems materializing in practice. In Dutch legal practice, the risk of undisclosed pledges (for simplicity: ‘the double pledge problem’) appears to be insignificant. When asked about the ‘double pledge problem’, most interviewees indicated that fraud of such kind occurs rarely, which corresponded to a quick and light search for published case law in the past 20 years, where only 4 conflicts of this nature came to the light.¹¹⁵ In addition, we saw that lenders take the existence of retention of title clauses in stride: there is no question of deceit committed. Further, although we have seen that the risk of unauthorized sales is somewhat more common than the double pledge problem, in general this risk is also relatively small. Even if this risk materializes in practice, a prospective buyer will often have reason to believe that the sales were made in the ordinary course of business and, hence, in good faith. Accordingly, the question is whether publicity would be of much help in this context, since in a system where a filing system is available, such unauthorized sales are likely to take place too (i.e. it is hard to believe that buyers in the ordinary course will be expected to consult the filing system: this would obstruct trade).¹¹⁶ Even when the subsequent buyer can be traced and cannot place reliance on a bona fide third party protection rule, lenders may not always easily recover the value of the sold assets. Hence, when we give some consideration to the extent of these legal risks due to the absence of public filing in practice, the question arises whether the cure is not worse than the disease. The fact that Dutch lenders argue that it is not cost-efficient to adopt a register to fight the problems due to the absence of public filing should in any event be taken seriously. It is telling that lenders claim to not always investigate whether earlier security rights have been created. They argue that it sometimes makes more sense to suffer occasional credit loss when the debtor defaults, and to factor this into the price of the credit, than to check whether (in a small number of cases) the debtor commits deceit, i.e. to know with certainty that the debtor who is applying for credit has not created earlier non-possessorial pledges on its movable assets. Hence, by putting the focus on scale efficiency, the lenders’ lax attitude on proposals to adopt a public filing system should not be traced back to perceived costs resulting from

¹¹⁴ See supra subsection 2.4.3 of Chapter 3.
¹¹⁵ See supra Chapter 3, subsection 3.1.4.3.
¹¹⁶ This is obviously different if the unauthorized sales concerned equipment, but such sales are even more infrequent.
searching this system, but to the fact that the disease is no more than an occasional cough:117

“In the rare event that things actually go wrong (because there is an earlier pledge), this constitutes breach of contract by the business in relation to the second bank. After all, the business is obliged to provide that bank with a first pledge. If this is not done, and the second bank thus suffers loss, the business must compensate it.”118

In my view, an important reason for the limited existence of deceit committed in Dutch legal practice is that the means to keep the debtor honest are effective and sufficient. First of all, a debtor that pledges its assets twice without being authorized to do so will simply be ‘done’ doing business. Or as bankers put it: ‘clients can commit such deceit only once’. Second, Dutch legislation has a significant deterring effect, exposing the deceiving debtor to criminal liability.119 Third, businesses that need to have their accounts audited are subject to the scrutiny of the auditors, who bear their own responsibility in conducting such audits. Strictly speaking, it is not impossible to also deceive the auditors since the accountant can confirm that a debtor has already pledged the assets to another lender, but not that the assets have not been pledged again. However, I believe that the obligation to go through an audit process will restrain debtors in doing so. With regard to the risk that a debtor pledges its assets twice, it would require professional skill to hide both pledges from the bank concerned and from an accountant conducting an audit on the annual accounts.

In relation to small business facilities, the risk of deceit does not seem a serious concern for other reasons.120 For those loans, lenders claim that especially when the collateral has little value, they in fact do not count on being able to realize value from the collateral and that such collateral is almost just a ‘nice to have’. Hence, although the risk of deceit would be greatest in this category – due to the fact that applications for loans are made and processed online – the following assumption on the use of publicity, precisely for these smaller businesses cannot be endorsed:

117 Beekhoven van den Boezem & Goosmann 2010b, p. 49. The position of debtors will be discussed in subsection 5. Whether it is really not cost-efficient to adopt public filing, would obviously only be known by lenders once they knew what the actual costs of a filing system would be. In any case, it is illustrative that the existing risks are so insignificant that lenders have not considered it worthwhile to think of another solution.
118 Beekhoven van den Boezem & Goosmann 2010a, pp. 44 and 53.
119 The debtor must declare that it is authorized to pledge the property and furthermore that the property is not encumbered with limited rights (which include rights of pledge), or if it is, by which rights it is encumbered; see art. 3:237(2) BW. See subsection 2.4.3 of Chapter 3. The debtor runs the risk of being criminally liable for forgery (see Art. 227 Sr.) or fraud (Art. 326 Sr.)
120 Beekhoven van den Boezem & Goosmann 2010b, p. 49.
“(…) it is precisely with smaller firms that publicity becomes more important, both as a means of preventing fraudulent backdating as well as of informing third parties, and it is with less valuable transactions that we stand to gain most from reducing search costs.”\(^{121}\)

Furthermore, I do not get the impression that lenders in a non-public filing system are in any way discouraged to provide loans, as Beale seems to suggest:

“It is generally agreed that, where a non-possessory security right is taken over assets other the financing collateral, a warning should be given to other people who may deal with the debtor. If that is not done, it may well be hard to discover whether there is a security interest; and this may discourage financiers from coming forward who cannot find out in other ways whether the debtor has created security over its property.”\(^ {122}\)

In sum, it seems fair to conclude that the costs incurred by secured lenders as a result of the absence of public filing are de minimis for two reasons. The first reason is that debtors simply do not commit such deceit very often in practice. Accordingly, lenders do not suffer much loss in their credit portfolio. At the same time – and this is the second reason – the means to mitigate this risk are not very costly for lenders, as the means to restrain the debtor from committing deceit are the fear from reputation damage and Dutch laws on liability. To the extent that the accountant has a role in mitigating this deceit, these costs cannot be replaced by a public filing system, given that the annual accounts will have to be audited regardless of whether a public filing system is present. To the extent that lenders do incur costs as a result of the fact that publicity is absent – both in terms of ‘mitigation costs’ and the materialization of the risk in their credit portfolio – these costs are passed on to the borrowers in the form of one or more credit surcharges.

“The chance that the business – which in practice is by now bankrupt – turns out to be no longer capable of this has already been taken into account in the price of the credit.”\(^ {123}\)

The position of debtors will be dealt with in section 5 of this chapter.

4.3.2. Selling trade creditors’ practice

The legal risk of proprietary conflicts is also very small in practice in relation to first-in-time secured trade creditors. First of all, with regard to the risk of deceit concerning earlier created security rights there is no question of any risk that the debtor is dishonest with regard to the legal status of such assets, because those assets do not (yet) belong to the debtor’s estate and trade suppliers can simply transfer those assets subject to retention of

\(^ {121}\) Beale 2012, p. 280-281.
\(^ {122}\) Beale 2008, p. 100.
\(^ {123}\) Beekhoven van den Boezem & Goosmann 2010a, p. 48 (translated).
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title or subject to the retention of a right of pledge.\textsuperscript{124} Put differently: given that the debtor does not actually grant these to the supplying trade creditor(s), but rather retains them at the time of transfer, the debtor cannot be guilty of deceiving these creditors. Consequently, a public filing system will be of no relevance to trade creditors who supply goods and who choose to take a security right or stipulate a retention of title over the goods so supplied. First-in-time secured trade creditors do run the risk of getting involved in proprietary conflict with future lenders and buyers. After all, secured trade creditors run the risk of losing their validly retained title if the latter are bona fide protected by law.\textsuperscript{125} Also in this context, however, loss of title will usually be caused by an accession or amalgamation or co-mingling, and rarely by an unauthorized sale on the part of the debtor. On the few occasions that this does occur, however, the same applies here as for lenders (because the same types of assets are involved): more often than not, prospective buyers will have reason to assume that the sales were made in the ordinary course and, hence, be acting in good faith, with the result that sellers are left empty-handed. Furthermore, even if a prospective buyer can be traced and cannot place reliance on a bona fide third party protection rule, it may not be easy to recover the value of the sold assets.

5. The consequences for debtors

The question of whether lenders suffer from the absence of public filing, and consequently incur costs was discussed in section 4. I concluded that the absence of publicity causes secured lenders to incur only minimal costs. To the extent that secured lenders do incur costs, however, these costs are passed on to the debtor in the form of one or more credit surcharges. Therefore, while lenders and other credit suppliers are happy to keep doing things “the way they were always done” and do not want to hear about reforms,\textsuperscript{126} it is appropriate to pay attention to the position of debtors themselves; this is the topic of the present section.

An oft-repeated argument in favor of the adoption of a public filing system and — as can be deduced from information presented in subsection 3.1.2 of Chapter 3 — quite rightly so, is that the absence of public information on security rights may have an adverse effect on the price of credit, and with that: on the debtor’s position.\textsuperscript{127} In Chapter 3, we

\textsuperscript{124} For Dutch law; see Art. 3:92 BW for retention of title and Art. 3:81(1) BW for right of pledge. The latter enables an owner of an asset to transfer such asset subject to a right of pledge retained by that owner; accordingly, the transferor does not acquire its right of pledge from its successor and never depended on its authority to create such pledge, but will simply have ‘retained’ it from the outset.

\textsuperscript{125} In Dutch law this would be on the basis of Art. 3:86 BW or Art. 3:238(1) BW.

\textsuperscript{126} See Simpson & Menze 2000, p. 19

\textsuperscript{127} See e.g. Stein 1972, p. 325, Vriesendorp & Barendrecht 1993, p. 55 and Comment B to IX. – 3:301 (DCFR); “[The, DJ]YH] possibility of obtaining information obviously also works to the advantage of the security provider. By being able to show that no security rights or retention of ownership devices are registered in relation to certain assets owned by the security provider, the latter can ensure the parties it is dealing with that they will be able to acquire unencumbered

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saw that the amount and quality of the assets that are offered to the lender as collateral have an impact on the lender’s Loss Given Default (‘LGD’), i.e. the loss that the lender will suffer after liquidation of the security in case of default. In simplified form, the more a lender is able to recover from the security, the lower the loss – and therefore also the Expected Loss – will be. Because both the credit risk surcharge and the solvency surcharge are related to the amount of the Expected Loss, (collateral) security – but also its quality – has a positive impact on the price that debtors must pay for their credit.128

Whether public information on security rights would lead to a quantifiably129 lower price of credit, however, is open to doubt. This is mainly because the influence of publicity in this matter is almost negligible. The amount of the LGD is influenced most by whether security is stipulated at all and, if it is, its ranking: these are both questions that are not resolved by publicity. Publicity may only help ensure that lenders actually have the rank that they agreed with the debtor to be given. As a result, publicity can only mitigate the costs that are incurred if the debtor is dishonest, or makes mistakes, in this regard. We just learned that the extent of this risk, although it differs from one sector to another, is generally very small.130 More importantly, this is just one of the risks to which the quality of the collateral is exposed. When it comes to the risk of loss, lenders run much greater “risks” with respect to their collateral, such as: the fact that it is subject to retention of title, the risk that the tax authorities have a certain higher ranking claim on the assets131 or the risk that the assets cannot be sold in an execution or only at a much lower price than anticipated. As a result of a change in market conditions, for example, certain types of assets may no longer be in demand, assets may no longer be sold at going-concern value, or must be sold unbranded (due to rules of brand protection). Last but not least, the

128 See supra subsection 3.1.2.2 of Chapter 3. Cf. Ibrahim & Koch 2009, p. 2. See e.g. Vos 2009, p. 29: “The weaker the cover for the credit, the higher the charged interest margin will be,” (translated).  
129 Quantifiable means: can be expressed in a number of basis points of the interest rate.  
130 The risk of the debtor committing deceit, either by being dishonest about an existing earlier lender or by selling the goods to third parties without permission, is “of all sectors” and is apportioned among all debtors.  
131 I reiterate from Chapter 3 that the Dutch tax receiver, in respect to certain categories of tax claims takes priority over non-possessory security, but only in respect to assets physically located ‘on the floor’ of the premises in use by the debtor and to the extent that such assets serve to upholster the floor (such as inventory (furniture) and equipment, but not stock). This is called the tax authority’s ‘bodemrecht’. See supra subsection 2.4.3 of Chapter 3.
Chapter 4

LGD is part of a wider formula, PD x LGD x EAD = EL, which determines (part of) the credit risk, and hence the corresponding price surcharges: the debtors PD has to be taken into account also. Hence, when public information on security rights would lead to a lower price of credit, this part is unlikely to fall beyond a few basis points of the interest rate. The costs of adopting and maintaining a filing system (and possible new conflicts to arise in this new system), however, are yet to be assessed. Last but not least, it is not clear whether lenders would actually reduce the surcharges in the case that publicity would be made available through the adoption of a public filing system. In theory, however, the absence of a public filing system may indeed have a negative impact on the price debtors pay for their credit.

6. Conclusions

Part I of this thesis scrutinized the need for public information on security interests. For this purpose, the current chapter identified the risks that several types of parties involved in secured transactions are exposed to when operating in a ‘non-public filing system’, i.e. in the absence of public information on security interests. The research produced various outcomes.

One important consequence of the absence of ‘publicity’ is that the debtor is in a position to cause lenders and buyers who intend to obtain a security right respectively to buy the asset, to believe that the assets are unencumbered, while in fact they are encumbered with a security interest or subject to retention of title. This may have adverse consequences for pertinent categories of creditors in several respects. First, it exposes first and second-in-time secured trade creditors, secured lenders and attaching unsecured creditors to a risk of ‘proprietary conflict’, i.e. a conflict where parties fight for the same (proprietary position in the) asset. This is undesirable viewed from the

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132 In adopting this approach, the starting point taken is that the Dutch case study has the ability to unfold the problems and risks faced by parties that are involved in secured transactions and operate within the borders of the European Union, because these parties have comparable commercial needs across borders; see supra Chapter 1, subsection E.1.

133 If the debtor offers certain (already encumbered) assets for collateral, second-in-time secured lenders and trade creditors (‘C’s) may not be protected by a third party protection rule because they do not satisfy the legal requirements, leaving them second in ranking or empty-handed. If they do meet the requirements for bona fide protection, this conversely entails a risk for first-in-time secured lenders and sellers (‘A’s): namely, that they may lose their interest or their ranking in the asset. See ‘Publicity of Security Rights: setting standards for charges registries’ (London: EBRD, 2005), p. 22: “Publicity enables third parties to discover that the creditor has a prior right in the asset. Publicity also enables the creditor to ascertain existing charges affecting charged assets.” On the position of ‘A’s in particular, see Jackson & Kronman 1979, p. 1143: “To a considerable extent, the value of a security interest depends upon the degree to which it insulates the secured party from the claims of the debtor’s other creditors.”

134 Unsecured creditors run the risk of becoming involved in a semi-proprietary conflict when they attach (part of) the debtor’s assets that have already been encumbered with a security interest. This is not a direct result of the debtor’s misbehavior and in that sense this proprietary conflict is of a slightly different nature. The lack of publicity prevents them from avoiding unnecessary attachment costs, given that they are not warned about the fact that these assets are worthless from the perspective of recovery.
perspective of various parties investigated in this thesis, since at least one of the parties involved will lose the proprietary conflict at its expense. Moreover, to the extent that this risk materializes in practice and lenders pass on these costs to their debtors in the form of one or more credit surcharges, these debtors pay a higher interest rate for their loans, i.e. incur costs they would not have incurred had publicity – in the abstract – been available.

Another important consequence of the absence of public information is that the moment that security interests take effect (against third parties) can be antedated fraudulently.\textsuperscript{135} This entails a risk for all (secured and unsecured) creditors of the debtor except the defrauding creditor itself, since the latter, by committing such fraud, feathers its nest at the expense of the debtor’s other creditors. This equally causes the parties investigated in this thesis to incur costs and sustain damage, which would had been avoided had publicity been available.\textsuperscript{136, 137}

Whether or not it is in the interests of the investigated parties to promote publicity in the form of a public filing system will ultimately depend on whether such filing system effectively addresses the aforementioned legal risks, and if so, if it does so in a manner that is cost-efficient for the parties concerned, i.e. in accordance with a cost-benefit analysis.\textsuperscript{138} Before moving to Part II and III of this thesis to explore whether Art. 9 UCC and Book IX DCFR have the ability respectively the potential to do so, I will give some thought, although in conceptual terms only, to the extent to which the aforementioned legal risks – proprietary conflicts and fraudulent antedating – manifest themselves in a non-public filing system. The Dutch case study did not only allow us to identify these risks, it also

\textsuperscript{135} This is only not so if the creation of undisclosed non-possessory security is subject to a requirement to ensure date-certainty, such as in the Netherlands. See supra Chapter 3, subsections 2.2.3-2.2.4.
\textsuperscript{136} The World Bank names precisely these two functions as legitimate purposes of registration: “Registration should serve only the legitimate purposes of registration. Those purposes are (i) to give notice that a security interest may exist in the identified collateral and (ii) to provide evidence of publicity as the basis for the secured party’s priority in the collateral (…)” “Secured Transactions Systems and Collateral Registries” (Washington DC: IFC, 2010), p. 67.
\textsuperscript{137} This outcome coincides to a great extent with legal literature on the publicity subject, in and outside Europe (see e.g. the previous footnote), except where public information is assumed to have the aim of informing prospective unsecured creditors about whether to enter into a relationship with the debtor. For the latter, it will not have escaped the reader’s attention that in my view publicity is of no relevance for unsecured (trade) creditors, no matter how pitiful their may seem to be. When considering the need to introduce such system, this particular interest of position of (unsecured) trade creditors should not put any weight in the scale, except to the extent that this information is to protect unsecured creditors that attempt to attach the debtor’s assets or, alternatively, to protect them (and other creditors) against fraudulent antedating. Cf. Baird about the use of public notice filing and the position of general unsecured creditors: “(…) article 9 provides virtually no assistance to unsecured creditors. Parties without ownership interests in the debtor’s property rarely check the filing system, and if they do they rarely learn anything. Article 9 UCC, principally serves the interests of secured creditors. (…) A notice filing system (…) sorts out property claims among those who have or seek property claims; its function is not to give the world at large notice of security interests.” See Baird 1983, p. 55. On p. 66 Baird continues: “In short, the Code’s notice filing system addresses principally only one kind of ostensible ownership problem – the one arising from competition between secured creditors.”
\textsuperscript{138} The ultimate aim of this approach is to assess whether it is likely that the adoption of a public filing system on a European scale will be economically efficient for the parties that are typically involved in secured transactions and operate within the borders of the European Union; see supra Chapter 2, subsection D.2.
gave some insight into the extent to which these legal risks materialize in legal practice and, as a consequence, the extent to which they contribute to costs. As both legal risks find their basis in fraud committed by the debtor (or by both the debtor and its secured lender) or incidental errors, it seems fair to conclude that such risks will only incidentally materialize. As a result, on average, the resulting unnecessary costs and potential damage for the investigated parties affected by such fraud will not be significant.\footnote{That non-public filing systems are not doing so badly was already predicted by White in 1995: "Recognizing that there are effective and apparently efficient lending systems in Europe, in countries that do not have filing systems like our own, and understanding that there are alternative sources for much of the information that a filing system provides, the drafters should approach the assertions of secured creditors with some skepticism, and should at least understand that they are drafting law based on assumptions about and in considerable ignorance of credit behavior." See White 1995, p. 531.} This precise analysis does not equally apply to attaching unsecured creditors, given that these creditors do not become involved in the same proprietary conflict in the sense that they have not been misinformed by the debtor. In other words, the nature of the legal risks they are exposed to is different: they are not defrauded. As a result, the number of cases that unsecured creditors attach already encumbered assets may be less rare, although no accurate figures to document this are available.

To conclude, when taking the interests of all\footnote{In this thesis, a public filing system is considered to be ‘efficient’ – and hence desirable – if, on balance, its adoption is beneficial to the parties concerned, regardless how the benefits are allocated amongst them; see supra subsection D.2.3.} of the investigated parties into account, I believe that the costs incurred by those parties in the absence of public information on security interests are unlikely to be significant.\footnote{I am aware that this research is limited to non-possessory security in movable, i.e. tangible assets only and that conclusions based on this research may not equally apply to other categories of assets that are covered by Art. 9 UCC and Book IX of the DCFR.} Hence, if the Dutch legal system was representative for all other EU-member states, in order to justify adoption a public filing system should – in addition to effectively addressing the legal risks above – meet a rather high minimum standard of efficiency in doing so. European literature shows that as far as the nature of the problems is concerned as discussed in this chapter, clear parallels can be drawn between the Netherlands and other EU-jurisdictions. However, not having expanded my research to all other EU-member states, it is unclear whether the Dutch results justify extrapolation to the EU as a whole: conceivably there may be differences in the extent to which the described problems and risks materialize in practice. With that caveat, Part II and Part III of this thesis will investigate whether Art. 9 UCC and Book IX DCFR meet this rather high standard.