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REFORMING PERSONAL PROPERTY SECURITY LAW IN MEXICO

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ABSTRACT

The present study is divided into two main parts. Part One discusses the nature, distinctive characteristics and weaknesses of the major types of possessory and non-possessory security interests in personal property currently available in the Mexican legal system under its Civil Code and various applicable commercial laws.

Part Two suggests some modern approaches that shall be considered for adoption in Mexico based largely on a comparison with the advanced structure of secured transactions under Article 9 of the Uniform Commercial Code of the United States, Book Six of the Civil Code of Quebec, and the Canadian Personal Property Security Acts. All may serve as effective models for Mexican legislators to follow in their aim to modernize personal property security law.

RESUME

La présente thèse se divise en deux parties. La première partie décrit la nature, les caractéristiques distinctives et les faiblesses des principales sûretés réelles mobilières du système légal mexicain contenues dans le Code civil et dans diverses lois commerciales.

La deuxième partie propose une réforme du système légal mexicain dans ce domaine. Ces propositions de réforme sont largement inspirées par comparaison avec les dispositions relatives aux transactions de sûretés contenues à l'article 9 de l'«Uniform Comercial Code» des Etats Unis, des Lois sur les sûretés mobilières canadiennes et le Livre Six du Code civil du Québec. Toutes ces dispositions peuvent servir de modèle à suivre afin de moderniser les lois relatives aux sûretés réelles mobilières à Mexique.

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INTRODUCTION

Capital and credit markets are essential for the development of a country's economy. International experience has demonstrated that the level of economic development inherent in a certain country is closely linked to the existence of large, stable financial markets, and therefore a country aiming to improve the quality of life of its citizens must promote its capital and credit markets. One of the main factors to explain differences in the size of financial markets between countries is the legal and institutional framework that guarantees in each of them the rights of property. It has been concluded that those countries that best defend the rights of property of shareholders and creditors have larger capital markets.[1] Therefore, capital markets will not usually develop in emergent countries because investors will be unwilling to extend credit if they are not given adequate legal protection for their rights and are not provided with security by the courts in order to recover their money when debtors do not or stop fulfilling their obligations.

Mexico has one of the worst creditor protection regimes in Latin America; in other words, the rights of creditors to oblige debtors to fulfill their financial obligations according to law are not secure. Moreover, Mexico has a deficient judicial system, little faith in the Rule of Law, and a high index of corruption. In view of this, the legal and institutional changes that Mexico needs in order to achieve a large, strong and efficient financial sector, contributing to the growth of income and employment, are evident. In essence, to make its financial markets stronger, Mexico needs to design a modern legal framework that protects the rights of property in secured lending arrangements (Security Law – *Ley de Garantías*) and creates a judicial system that makes them effective (Bankruptcy Law – *Nueva Ley de Quiebras*).[2] Unfortunately, these changes are still

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[1] See S. Kalifa, "Marco Legal y Mercados Financieros (I)" *El Norte* (17 March 1999).

[2] See S. Kalifa, "Marco Legal y Mercados Financieros (II)" *El Norte* (24 March 1999).

Mr. James F. McCabe, President of AmCham/Mexico (American Chamber of Commerce in Mexico), also emphasized the need for Mexico to work on such important issues as a new Security Law

pending because Mexican authorities and legislators have not found the appropriate political moment to realize these goals. Mexico will not achieve a modern banking system that contributes to economic development if it continues to postpone legal reform.[3]

The Mexican legal community has been struggling for many years with the almost unworkable scheme for security interests found in both the Civil Code and various commercial laws.[4] In Mexico, security devices have been developed through the provisions of both of these branches of law pertaining to the civil and commercial pledge, together with special statutes created to deal particularly with non-possessory security interests. By regulating personal property security devices under both the Civil Code and the applicable commercial laws, depending on the commercial or non-commercial nature of the transaction, Mexican personal property security law is currently in a state of confusion; secured credit devices are mixed up, resulting in the lack of integration between the procedures and the substantive features involved in secured transactions. Moreover, rather than adopting principles from the contemporary commercial lending marketplace, Mexican law has allowed the complicated and archaic rules governing immovable (real estate) secured financing in Mexico to control personal property secured transactions. "Predictably, Mexican secured financing mechanisms have failed in their mission to promote the availability of commercial credit."[5]

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and a new Bankruptcy Law in order to better protect investors. See J. Gerber "A Nivel Histórico, El Ahorro Interno: UCSD, El Blindaje Financiero, Notable Diferencia" *Excelsior/Financiera* (6 August 1999).

[3] See S. Kalifa, "Las Deficiencias del IPAB" *El Norte* (9 June 1999).

[4] Mexico's commercial laws are of a national application, but the civil codes and their procedural counterparts are left to the states to regulate. However, where local-state law is the primary source, the legislation of the Federal District shall be surveyed for the purposes of this study since it is often partially or entirely reproduced in all of the other 31 states. See *Constitución Política De Los Estados Unidos Mexicanos*, arts. 43, 120 & 124 [hereinafter *Mexican Constitution*]. The Mexican Constitution was published in the Federation's Official Gazette on 5 February 1917.

[5] B. Kozolchyk, "What to Do About Mexico's Antiquated Secured Financing Law" (1995) at 3, online: NLCIFT, <http://www.natlaw.com/pubs/bk9.htm> (date accessed: 1 February 2000).
See also B. Kozolchyk, "What to do About Mexico's Antiquated Secured Financing Law" (1995) 12 AZ. J. Intl. & Comp. L. 523 ff.

Dr. Boris Kozolchyk is an expert in Latin American credit. As the founder of the National Law Center for Inter-American Free Trade (NLCIFT), he has been promoting legislative modernization in the

The current Mexican system for secured transactions is similar to that which existed in the United States before the advent of the Uniform Commercial Code (UCC) in the 1950s and 1960s, where lenders' collateral interests were secured by a great "crazy-quilt" variety of devices. The UCC[6] did away with all these devices by imposing a single standard (the security interest) perfected by a single method (filing in a common registry on a standard form), building a systematic structure for all types of security interests through codification. In Mexico, however, even today any attempt to secure a loan is likely to be complex, quite formal, expensive and time-consuming.[7] In short, Mexico's scheme of security interests in movable property has proved unsuitable to meet the financial demands of today's increasingly sophisticated industrial and commercial development.[8]

After recognizing the necessity for an updated codified law for security interests, what Mexico needs is an overall reform to its personal property security law. However, it would be foolish to expect such law reform to solve every financing problem; progress in secured transactions does not involve the simple reproduction in one jurisdiction of the

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area of secured financing for many years, and he initiated the Secured Financing Project in order to complete a thorough investigation of all aspects of law and practice relating to personal property secured financing in Mexico, with a view toward assisting the Mexican government with law reform efforts.

[6] References to Article 9 of the UCC are based on the 1972 version of the text.
See American Law Institute, *Uniform Commercial Code* (Philadelphia, Pa.: <s.n.>, 1972).
Article 9 of the *Uniform Commercial Code* was prepared jointly by the American Law Institute and the Conference of Commissioners on Uniform State Law. The first official text of Article 9 was promulgated in 1952. Very substantial amendments were made in 1972. It is currently under review and substantial changes in it can be expected in the near future.

[7] See D.B. Furnish, "Mexican Law on Secured Transactions", Philip T.von Mehren (Curtis, Mallet-Prevost, Colt & Mosle), SMU ed., *Doing Business in Mexico*, vol. 2 (Ardsley, New York: Transactional Publishers, Inc.; 1999) ss. 37.01. See also A.M. Garro, "Security Interests in Personal Property in Latin America: A Comparison with Article 9 and a Model for Reform" (1987) 9 Houston J. of Int'l L. 157 at 200; V. Levine, "Secured Loans" (1946) A.B.A. Sec. Leg. Ed. Prac. L. Inst. 1-30, defining a vast array of pre-Article 9 security devices; G. Gilmore, *Security Interests in Personal Property* (Boston: Little, Brown, 1965) at 5-250; and W.B. Davenport & D.R. Murray, *Secured Transactions* (Philadelphia, Pa.: American Law Institute-American Bar Association Committee on Continuing Professional Education, 1978) at 3-7.

[8] See A.M. Garro, "The Reform and Harmonization of Personal Property Security Law in Latin America" (1990) 59 Revista Jurídica Universidad De Puerto Rico 1 at 4 & 5 [hereinafter "Reform and Harmonization"]. Prof. Alejandro M. Garro, a native of Argentina, is a law lecturer at Columbia University School of Law and a key member of the Secured Financing Project at the NLCIFT. He is also helping to guide The World Bank's reform efforts in other Latin American countries.

laws of another without carefully considering the unique social and economic situation of the adopting country. The idea of introducing some of the approaches presented in Article 9 of the UCC, the Canadian Personal Property Security Acts (PPSAs), and the Civil Code of Quebec (CCQ) should always take into account the particular needs and business practices inherent in Mexico's developing economy and civil law system. This proposed overall reform of personal property security law in Mexico must recognize its own limitations in its aim of providing merchants and traders with simple mechanisms for commercial transactions' financing.[9]

While attitudes seem to support commerce and credit in Mexico, the legal mechanisms chosen to implement the central banking policy of making credit more available have largely failed. To identify the origins of this failure, it is necessary to understand the function and operation of the different civil and commercial security devices, as well as of the public registries.[10]

The approaches proposed in this study as models for reform in Mexico can be briefly summarized as follows:

(1) Replacing the Mexican Civil Code and various schemes from applicable commercial laws on regulating the civil and commercial pledge, as well as the numerous statutes that have been created to regulate the different types of non-possessory security interests, by a new single law (Security Law – *Ley de Garantías*) that regulates all security interests for personal property in a simpler and more unified way, without distinguishing between the commercial or non-commercial nature of the transaction;

(2) Designing a coherent and comprehensive legislation that encourages party autonomy in the creation of security interests;

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[9] See *ibid.* See also B. Kozolchyk, "Commercial Law Recodification and Economic Development in Latin America" (1972) 4 Law. Am. 189 at 199 [hereinafter "Commercial Law Recodification"]. ["The import of 'exotic' institutions on the sole basis of their success in a foreign jurisdiction or their doctrinal acceptability, if not coupled with an actual need for such institutions only results in a distorted or pathological use"].

[10] See Kozolchyk, *supra* note 5 at 2.

(3) Expanding the property subject to non-possessory security interests to the point where one can create a security interest for virtually any kind of movable property, be it corporeal or incorporeal, present or future, specific or in a state of constant change;

(4) Reducing formalities and detailed content as legal requirements on security agreements;

(5) Liberalizing default procedures, so that secured creditors have considerable freedom in exercising their remedies when a debtor defaults;

(6) Substituting Mexico's transactional registration system for a system of notice filing, and additionally, expanding the availability of pre-filing;

(7) Introducing computer technology into the registry system to create a more sophisticated Mexican Public Registry of Property and Commerce; and finally,

(8) Creating a single set of general rules of priority for both merchants and non-merchants, abandoning the insolvency proceedings currently available under the Mexican Civil Code and Bankruptcy Law; and replacing the approach where priority is based on the time of actual registration of the security agreement for one where the date of filing should be considered as the relevant date for priority determination pertaining to competing security interests (Bankruptcy Law – *Nueva Ley de Quiebras*).

Part One discusses the nature, distinctive characteristics and main weaknesses of the major types of possessory and non-possessory security devices under Mexico's current regime on personal property security law.

Part Two proposes, based principally on Article 9 of the UCC, the Canadian PPSA's, and to a lesser extent, on the CCQ, several modern approaches that should be considered for adoption in Mexico to confront those areas of Mexican personal property security law in need of reform. Article 9 is used as the main source for consideration in this study because the United States is by far the main trading partner of Mexico.

PART ONE

THE CURRENT LEGAL FRAMEWORK OF SECURITY INTERESTS IN MEXICAN LAW

I. INTRODUCTION

Mexico has a wide variety of secured financing mechanisms to choose from. However, selecting amongst them is a daunting task for Mexican lawyers, since if the wrong device is chosen the lender and the borrower might face unforeseen consequences. The devices available under Mexican law discussed herein include the civil pledge; the civil pledge without dispossession (non-possessory pledge); the commercial pledge, including its non-possessory variations *habilitación o avío* and *refaccionario*, the bailment pledge, the banking pledge, commercial sales contracts; conditional sales contracts; the movable hypothec; the industrial hypothec; the financial lease; and the guarantee trust. All these legal devices used in secured lending are the remains of Roman law, Spanish Colonial law, and French law mechanisms not well suited to modern day financing.[11] In order to understand what is demanded of the present Mexican legal mechanisms, it is first necessary to understand the main functions of such mechanisms under the Mexican secured financing system. Therefore, Part One analyzes the existing Mexican secured financing law, giving a brief description of each mechanism while additionally pointing out their principal weaknesses.

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[11] See J.M. Wilson-Molina, "Mexico's Current Secured Financing System: The Law, the Registries and the Need for Reform" (1997) at 7, online: NLCIFT, <http://www.natlaw.com/pubs/spmxbk3.htm> (date accessed: 1 February 2000). John M. Wilson-Molina is a member of the Secured Financing Project at the NLCIFT.

II. PLEDGE

A. CIVIL OR TRADITIONAL PLEDGE *(PRENDA)*

Through the years, many Mexican legal scholars have defined "pledge".[12] Summarizing all these conceptualizations, it seems that the most appropriate definition is: *PLEDGE* is a real[13] and accessory[14] contract that gives rise to a real right of security (right *in rem*). It embraces property that is movable, alienable, determined, and which may be real or legally delivered by the debtor or a third party to the creditor or a third

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For a detailed explanation of the historical background of the basic structure of Latin American secured financing laws see also Garro, *supra* note 7 at 162-169.

[12] Such legal scholars as Rafael Rojina Villegas, Ricardo Treviño García, Ramón Sánchez Medal, Oscar Vásquez Del Mercado, Salvador Ruiz De Chávez y Salazar, Salvador Ruiz De Chávez Ochoa, Joaquín Rodríguez Rodríguez, Carlos Felipe Dávalos Mejía, Ernesto Gutiérrez y González, Rafael De Pina, Rafael De Pina Vara, and Manuel Borja Soriano, among others. For a list of the literature, see Bibliography, below.

[13] The pledge, which is a *contract of real security*, as opposed to one of *personal security* (i.e., suretyship), has as its principal finality to guarantee the creditor the payment of his credit by means of a special power granted by contract over the pledged property in case the debtor defaults on his obligations. See R. Treviño García, *Los Contratos Civiles Y Sus Generalidades*, 5th ed. (México: McGraw-Hill, 1995) at 694-695.

[14] The pledge is an *accessory contract*, given that the contract of pledge cannot exist by itself; it depends upon the principal obligation underlying it. However, there are some exceptions to this accessory feature: (i) in case the debtor pledges future obligations (See *CCDF*, *infra* note 16, art. 2870); (ii) in case the pledge is created without the debtor's consent, then the principal obligation is separated from that of the accessory one regarding the debtor (See *CCDF*, *ibid.*, art. 2867); and (iii) in case of novation, where the pledge does not terminate along with the principal obligation (See *CCDF*, *ibid.*, art. 2220). As a result, both obligations do not necessarily have to coexist attached to each other; it is sufficient for both to coexist at a certain moment so that the accessory obligation becomes effective (See S. Ruiz De Chávez Y Salazar & S. Ruiz De Chávez Ochoa, *Importancia Jurídica y Práctica de las Clasificaciones de los Contratos Civiles*, 2nd ed. (México: Editorial Porrúa, 1997) at 133-135). Nevertheless, if the principal obligation is paid off, or is held to be null, the contract of pledge shall be automatically extinguished (See *CCDF*, *ibid.*, art. 2891). In addition, one should bear in mind that the extinction of the contract of pledge does not extinguish the principal obligation, since the principal obligation can always exist by itself. The accessory nature of the security interest is a general feature applicable to various issues within the relationship between such interest and the principal obligation. For example, the accessory feature applies regarding the enforcement of the security interest (the security interest will be enforceable only if the principal obligation to which it accedes is also enforceable), the assignment of the secured obligation without the security interest *(cesión de deuda)*, or the assignment of the security interest without the secured obligation *(cesión de derechos)*. See Garro, *supra* note 7 at 205.

In Mexico's civil law system, the classification of contracts as principal and accessory is very common. Famous Civilists like Planiol and Ripert call principal contracts "independent" and accessory contracts "dependent". (See Planiol, M. & Ripert, G., *Tratado Práctico de Derecho Civil Francés*, t. VI, núm. 44 (Cuba, Cultural, 1946) at 60-61). Surprisingly, authors often confuse accessory contracts with contracts of security (suretyship, pledge, mortgage or hypothec) because, even though the latter are the usual types of accessory contracts, they are not the only ones, except that they are accessory by nature (they can never be principal contracts) and not accessory due to party autonomy. Actually it is not the contract

party for the purpose of securing the fulfillment of a principal obligation and its preference in payment.[15] The legal concept of pledge is similarly defined by Article 2856 of the Civil Code for the Federal District.[16]

The pledge is considered to be *civil* by exclusion. That is, every time that the pledge is not *commercial*, as will be explained later on in this study, it will be *civil* and consequently shall be regulated by the provisions of the Civil Code for the Federal District (Civil Code, Mexican Civil Code or CCDF) or the Civil Code of any state, as the case may be.[17]

Both the Civil Code and the applicable commercial laws in Mexico refer to the security agreement between the creditor (pledgee) and the debtor (pledgor) as a contract,[18] and the security or property interest held by the creditor over the collateral as a

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that is accessory but the obligation of the surety, pledgor, or mortgagor/hypothec debtor. See Ruiz De Chávez Y Salazar & Ruiz De Chávez Ochoa, *ibid.* at 118-121.

[15] The pledge is the only *real contract* that can be found in Mexican legislation. [Real contracts, as opposed to consensual contracts, "are those in which it is necessary that there should be something more than mere consent" of the contracting parties, "such as a loan of money, deposit or pledge, which, from their nature, require a delivery of the thing *(res)*."] H.C. Black, *Black's Law Dictionary*, 6th ed. (St. Paul, Minn.: West Group, 1991) *s.v.* "Contract - consensual and real".

The pledge is also a *formal contract* given that it is required by law to be in writing. If it is created under a private document, then two copies are to be issued, one for each party. The contract of pledge will not become effective against third parties if there is no certainty as to its date of registration, public deed, or by any other reliable means (See *CCDF*, *infra* note 16, art. 2860).

[16] The Civil Code for the Federal District (CCDF) was published in the Federation's Official Gazette on 26 May 1928. The CCDF applies to the Federal District concerning common matters and to the whole of the Mexican Republic concerning federal matters.

[17] See Treviño García, *supra* note 13 at 700.

[18] In some Latin American civil codes, the rules governing the pledge are found in the section designated to rights *in rem*; nevertheless, the Mexican Civil Code regulates the pledge as one of the various types of contracts within Book Four, which is the section dealing with conventional obligations.

The right and the obligation derived from the contract of pledge are indivisible, unless it has been agreed otherwise. Nevertheless, when the debtor is entitled to make partial payments and several things have been pledged, or one that is comfortably divisible, the pledge will be reduced proportionally according to the payments made, always leaving the rights of the creditor effectively secured (See *CCDF*, *supra* note 16, art. 2890).

The transfer of the pledge is governed by the rules relative to the different forms for transfer of obligations. There are three ways in which a pledge may be transferred: (1) Assignment of Rights *(cesión de derechos)* (See *ibid.*, arts. 2029-2032), (2) Subrogation *(subrogación)* (See *ibid.*, arts. 2058 & 2059), and (3) Assignment of Claim *(cesión de deuda)* (See *ibid.*, arts. 2051 & 2055). In the first two cases, the person who changes is the creditor, not the debtor. In such cases, the contractual pledge situation remains the

right *in rem (derecho real)*.[19] This characterization is very similar to the distinction between security agreement[20] (meaning a contract) and security interest[21] (meaning a right *in rem*) under Article 9 of the UCC.[22]

A real or legal delivery of the movable property given as collateral by the debtor to the creditor to secure his obligation is required for perfection of the pledge.[23] In other words, there is no contract of pledge unless the collateral is delivered to the creditor or a third person. The pledge is considered to have been legally delivered (constructive delivery) to the creditor (i) when the creditor and the debtor agree that the possession of the collateral is given to a third party; or (ii) when by agreement between the contracting parties or expressly authorized by law, the debtor stays in possession of the collateral. However, in both cases, for the pledge to be perfected and become opposable against third parties, it must be registered in the corresponding Public Registry. In case the

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same. In contrast, in the third case, what changes is the debtor and therefore the situation changes significantly. The reason for this can be explained in a scenario where, for example, a third person pledges certain property in favor of the original debtor due to friendship and later there is a change of debtor. This changes the circumstances, and it is reasonable to expect that such third person, who had granted a security interest in favor of his friend, should be unwilling to respond for the new debtor. See Treviño García, *supra* note 13 at 708.

[19] See generally *ibid.*, arts. 2856-2892.

[20] Article 9 does not literally require that the creditor and debtor have a contract. However, U.C.C. section 9-203(1) states that a security interest would not attach unless the secured party is in possession pursuant to "agreement". This section does not specify that the agreement must be a security agreement. In spite of the fact that the Code omits the word "security" when referring to a pledge arising pursuant to an agreement, the fact remains that there can be no pledge unless there is an intent to create a security interest within the agreement. U.C.C. section 9-105(1)(1) tells us that a "security agreement means an agreement which creates or provides for a security interest", so that the pledge must be made pursuant to a security agreement. Garro, *supra* note 7 at 202.

[21] "U.C.C. section 1-201(37) defines a "security interest" as "[a]n interest in personal property or fixtures which secures payment or performance of an obligation." This definition implies that the secured party (pledgee) has some sort of property right in the collateral which can be properly conceptualized in civil law systems as a right *in rem*." See *ibid.*

[22] See *ibid.*

[23] See *CCDF*, *supra* note 16, art. 2858.

collateral is delivered to the creditor (real delivery), the security interest is perfected from the time possession is taken.[24]

The object of the contract of pledge involves property that is movable, determined, and alienable[25] (property that can be sold). Such movable property may include: (i) future property, such as fruits pending from real estate that should be harvested at a determined time; (ii) credit instruments;[26] (iii) personal rights, namely, credits; (iv) real rights, with the exception of those that are not transferable during the life of their holder (e.g., ownership over movables, usufruct over movables, right of bare legal title over movables, right of pledge (pledge over pledge), right of mortgage credit, and copyright).[27]

A civil possessory pledge is created when the collateral is delivered to the creditor (real delivery), who has the duty to return it to the debtor once the principal obligation is extinguished.[28] An example of this would be when a debtor (Mr. X), by written contract, pledges goods such as leisure or luxury items (e.g., jewelry) to the creditor (Mr. B) to secure payment for the loan "$" granted. Here, dispossession of the goods would be of no great inconvenience.

On the other hand, in a civil non-possessory pledge (civil pledge without dispossession) there is no dispossession of the collateral (legal or constructive delivery);

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[24] See *ibid.*, art. 2859. See also Treviño García, *supra* note 13 at 696.
[25] The innovation introduced by Mexican law, expressly declaring that movable property that acts as collateral under the contract of pledge must be "alienable" is unnecessary because the object of the pledge must inevitably fulfill such characteristic, otherwise such contract would not be able to reach its principal finality. See Ruiz De Chávez Y Salazar & Ruiz De Chávez Ochoa, *supra* note 14 at 122.
[26] See Section I.A.2., below. For detailed information on this type of pledge under the Civil Code provisions, see Treviño García, *supra* note 13 at 700.
[27] See Treviño García, *ibid.* at 697.
[28] See *ibid.* at 699.

the debtor or a third party remains in possession of the movable.[29] An example of this would be when a debtor (Mr. X), by written contract, pledges his automobile to secure payment to the creditor (Mr. B or the Bank) for the loan "$" granted, but now the debtor retains possession of the good necessary for his livelihood.

B. COMMERCIAL PLEDGE – IN GENERAL *(PRENDA MERCANTIL)*

The concept of the commercial pledge[30] is the same as for the civil pledge.[31] However, unlike the civil pledge, which is regulated by the Civil Code, the commercial pledge is not regulated by a single code but rather by different commercial laws, such as: *Código de Comercio* (Commercial Code),[32] *Ley General de Títulos y Operaciones de Crédito* (General Law of Instruments and Credit Operations or LGTOC),[33] *Ley de Instituciones de Crédito* (Law of Credit Institutions or LIC),[34] and *Ley del Mercado de Valores* (Law of the Stock Market or LMV).[35] The ranking of the pledgee's rights with respect to other secured and unsecured creditors is regulated by the *Ley de Quiebras y Suspensión de Pagos* (Bankruptcy Law or LQSP).[36]

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[29] See *ibid.*

[30] For a detailed explanation of the commercial pledge and its formalities, the rights and obligations of the pledgor and pledgee, and default procedures, see J. Rodríguez Rodríguez, *Derecho Mercantil*, 21st ed. (México: Editorial Porrúa, 1994) at 233-242.

For a detailed explanation of the commercial pledge in general, see C.F. Dávalos Mejía, *Derecho Bancario Y Contratos De Crédito*, 2nd ed. (México: Editorial Harla, 1996) at 732-740.

[31] See Section I.A.1., above.

[32] The Commercial Code was published in the Federation's Official Gazette on 15 September 1889. Articles 605 to 634 of the *Código de Comercio* [hereinafter *Commercial Code*], some of which also regulated the commercial pledge, were abrogated by transitory Article 3 of the LGTOC. However, the Code governs generally commercial matters related indirectly with the commercial pledge.

[33] The LGTOC was published in the Federation's Official Gazette on 27 August 1932.

[34] The LIC was published in the Federation's Official Gazette on 18 July 1990.

[35] The LMV was published in the Federation's Official Gazette on 2 January 1975.

[36] The LQSP was published in the Federation's Official Gazette on 20 April 1943.

Unlike civil law, and in accordance with Article 73(x) of the Mexican Constitution, commercial law is a subject matter reserved for the Federal Congress. Therefore, all these commercial laws regulate federally, not on a state by state basis. Furthermore, it is very important to know that in case some matters regarding the commercial pledge are not provided by this mentioned group of laws or there are gaps between them, the Civil Code for the Federal District is the law that shall be properly applied as supplementary (See *Commercial Code*, *supra* note 32 art. 2).

Qualifying a pledge as commercial or civil is extremely important since it will determine the applicable law for its creation and the procedure to follow in case the debtor defaults and the pledged collateral must be sold to pay the creditor. A pledge qualifies as commercial when: (i) it secures an act of commerce;[37] (ii) the collateral or *res* is of a commercial nature;[38] or (iii) it is granted by a merchant.[39] All obligations, both civil and commercial, may be secured by a commercial pledge.[40]

Under Article 334, the LGTOC authorizes the constitution of the pledge in commercial matters by:

> (i) Delivery to the creditor of the goods or credit instruments, if the latter are to the bearer. This is probably both the oldest and simplest type of pledge used. It is not required to be put in writing; nevertheless, it is advisable to do so in order to specify clearly the rights and obligations of the pledgor and pledgee.
>
> (ii) The endorsement of the credit instruments in favor of the creditor, if they are nominative, and by this same endorsement and the corresponding record in the registry, if the instruments are those mentioned under Article 24. This type of pledge may involve, for instance, stock certificates.
>
> (iii) The delivery to the creditor of the instrument or document in which the credit is evidenced, when the instrument or credit object of the pledge are non-

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[37] *ACTS OF COMMERCE*, in accordance with the Commercial Code, are: the operations of banks, contracts in regard to maritime commerce, insurance agreements, deposits for commercial reason, deposits in general, warehouses and the operations with certificates of deposit and pledge bonds, checks, money remittances, obligations of merchants, obligations of merchants in favor of bankers, and any others of similar nature (art. 75); the agency agreement (*comisión mercantil*) (art. 273); loan agreement when funds are to be used in a commercial activity (art. 358); sales agreement when made in a professional manner (art. 371); and transportation contract (art. 576). However, the foregoing list is not exhaustive, since there are more acts of commerce qualified as such by special commercial legislation.

[38] *MERCANTILE RES*, in accordance with the LGTOC, are all the credit instruments (art. 1), and specifically recognizes as such the following: the bill of exchange (art. 76), the promissory note (art. 170), the check (art. 175), debentures (art. 208), certificates of participation (art. 228), certificates of deposit and pledge bond (art. 229).

[39] *MERCHANTS*, in accordance with the Commercial Code, are: (i) individuals having the legal capacity to engage in commerce, making it their regular activity; (ii) the corporations incorporated in accordance with the commercial laws, and (iii) the foreign corporations, their agencies or branches that engage in acts of commerce within the national territory (arts. 3 & 4).

[40] See Rodríguez Rodríguez, *supra* note 30 at 235.

negotiable, with inscription of the lien in the registry of the issuer of the instrument or by notification to the debtor, if the instruments or credits require such inscription. This refers mainly to pledges on bonds, debentures, etc.

(iv) The deposit of the goods or instruments, if the latter are to the bearer, with a third party designated by the parties and at the disposal of the creditor. This is simply a variation of the pledge authorized under section (i).

(v) The deposit of goods, at the disposal of the creditor, in places where keys remain in possession of the latter, even though such places are owned or are located on the premises of the debtor. This is another variation of the pledge authorized under section (i). It is seldom used because, among other reasons, possession of the keys by the creditor does not always ensure him access to the place where goods are deposited.

(vi) The delivery or endorsement of the instrument representative of the goods that are the object of the contract, or by the issue or the endorsement of the corresponding pledge bond. This is a commonly used pledge, relatively risk-free for the creditor.

(vii) The registration of the *refaccionario* or *habilitación o avío* credit agreements, under the terms of Article 326. These two types of pledge, discussed later in this study, are also very popular in Mexico and are used mainly to secure bank loans.

(viii) The fulfillment of the requirements set forth in the LGTOC, in the case of book credits. This is a pledge on accounts receivable authorized only in favor of credit institutions. Banks consider it of high risk and therefore seldom, if ever, use it.[41]

[41] Some of the foregoing pledges do not require a written form for its creation; nevertheless, it is advisable to document any and all of them in writing, as a matter of proof not only against the pledgor but also against whomever might challenge them, and in order to establish with certainty the identity of the secured obligation, and the rights and obligations of the parties.

Closely resembling the Roman pledge, the commercial pledge, as a general rule, requires delivery of the collateral to the creditor or to a third party as trustee.[42] As with the civil pledge, there obviously would be no great inconvenience if dispossession of the pledged goods consisted of leisure or luxury items such as jewelry. However, this kind of pledge will not work when the debtor must retain possession of the goods to continue commercial operation. "Therefore, when pledged goods are necessary for the livelihood of the debtor, delivery of possession to the creditor will impair the debtor's ability to conduct business and therefore hinder he ability to repay the loan."[43] Examples of this disadvantage are in the financing of inventory and equipment, where the debtor must retain the goods for use and sale.[44] Professor Garro concludes:

> This drawback of the pledge is felt by consumers and merchants alike, so it makes little sense nowadays to regulate possessory security interests in the civil codes and deal with non-possessory security interests in the commercial codes. The consumer borrower or purchaser will probably not be willing to wait until the last installment of the loan or purchase has been paid in order to begin using goods such as stoves, refrigerators, sewing machines, etc. Likewise, the commercial borrower, who needs the use of the collateral in the course of his daily business, will be unwilling or unable to hand over the property to the creditor. The disadvantages of the delivery requirement also fall upon the creditor, who usually cannot afford the expense and inconvenience of storing the debtor's property. These practical drawbacks account for the decline in use of the traditional pledge in contemporary commercial and consumer transactions.[45]

Mexican legislators addressed the problem presented by such dispossession by providing the system with some mechanisms as exceptions where lenders could set up non-possessory security interests in personal property.[46]

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[42] See *LGTOC*, *supra* note 33, arts. 334-346. See also Rodríguez Rodríguez, *supra* note 30 at 236.
[43] See Wilson-Molina, *supra* note 11.
[44] See *ibid.*
[45] Garro, *supra* note 7 at 172.
[46] The rules of the traditional civil and commercial pledge found in the Civil Code and various applicable commercial laws are the backbone upon which the legal framework of all the different forms of non-possessory security interests is based. Unfortunately, sometimes the regulations of the various forms of non-possessory security interests in special legislation are not as comprehensive as Mexican legislators desired them to be. Consequently, when gaps are present in statutes regulating non-possessory security, it

III. NON-POSSESSORY SECURITY INTERESTS

The need to permit the debtor to use and enjoy the property he offered as collateral became clearer when Mexico's agricultural and industrial economies began to expand. Nevertheless, the creation and characterization of new forms of non-possessory security introduced practical and theoretical problems. At the practical level, the main problem was the lack of a registry system for movables by which third parties could be put on notice of the debtor's encumbered movable property. At the theoretical level, the concern was that the Civil Code and the applicable provisions of commercial law mostly referred to and dealt with possessory security interests where actual delivery of the collateral was made to the creditor. As a result of these practical and theoretical problems, the evolution of non-possessory security interests in Mexico has been slow and imperfect.[47]

Mexican legislators confronted these problems by treating non-possessory pledges as an extension of the traditional pledge rather than as a hypothec over movable property. Consequently, the non-possessory pledge *(prenda sin desplazamiento)* was created as a form of non-possessory security. Unfortunately, this new perspective towards non-possessory security also brought about several terminological problems.[48] For example, for the common lawyer, the use of the word pledge for a secured transaction that does not involve transfer of possession of the collateral must seem very strange indeed, but not more strange than it is for the civil lawyer to speak of a movable hypothec, keeping in mind that under the conceptual scheme followed after the French Civil Code, a hypothec may exist only with respect to immovables. However, some Mexican lawyers use the

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is commonly necessary to fill such gaps by resorting by way of analogy to the rules of the traditional pledge found in the civil codes. See *ibid.*

[47] See *ibid.* at 173.

common law term "chattel mortgage" (movable hypothec, *hipoteca mobiliaria*) to describe a non-possessory security interest in movables, notwithstanding the traditional conceptual difference between a mortgage and a hypothec.[49] This classification became possible when the Mexican Civil Code ceased limiting the concept of mortgage or hypothec to immovable property.[50] In addition to the movable hypothec, the Mexican Civil Code also allows the creation of a pledge with "constructive" or "legal" delivery, namely, the non-possessory pledge.[51] It is noteworthy that in Mexico movable hypothecs and pledges with constructive delivery are regulated by the Civil Code and are therefore applicable in principle to civil, or non-commercial, transactions. In commercial transactions, typical non-possessory security interests are those created under the *habilitación o avío* or *refaccionario* credit operations regulated by the LGTOC. However, nothing prevents merchants from agreeing on a movable hypothec or pledge with constructive delivery pursuant to the provisions of the Civil Code; nevertheless, in case of a debtor's insolvency, the *habilitación o avío* and *refaccionario* credit transactions have a more favorable ranking status than the civil devices.[52]

During the twentieth century, Mexico enacted statutes and modified others already in existence to allow the use of non-possessory security interests for movable property. Nevertheless, unlike the uniform regime of the traditional pledge, statutes dealing with non-possessory security have not been introduced in an organized fashion.

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[48] See *ibid.* at 174.

[49] See V. Folsom, "Chattel Mortgages and Substitutes Therefor in Latin America" (1954) 3 Am. J. Comp. L. 477 at 478.

[50] Article 1823 of the Mexican Civil Code of 1884 limited hypothecs to immovables, but Article 2893 of the present Civil Code, enacted in 1928, no longer includes the word "immovables" in the definition of hypothec. Hypothec is now defined as a proprietary right of security involving property that is not delivered to the creditor and which, in the event of nonperformance of the secured obligation, gives such creditor the right to be paid out of the value of that property with priority as established by law.

[51] See *CCDF*, *supra* note 16, art. 2858 & 2859.

The first statutes involving non-possessory security interests were created to apply to agricultural transactions, and as time passed more statutes were enacted for other categories of goods, such as industrial equipment. These changes clearly demonstrate the areas where the demand for non-possessory security interests became stronger in accordance with the different courses of economic development in Mexico. As a result, the scope of application and flexibility of the laws regulating non-possessory security interests is closely related to the period of time in which they were created.[53]

In Mexico, there are two special types of non-possessory security interests that permit the debtor to retain possession of raw materials and equipment for manufacture and production. These two types of pledge, which constitute an exception to the general rule that prescribes delivery of the collateral to the creditor or to a third party, were created to finance the operational expenses and economic production of a business, rather than consumption. Both of them, being commercial in nature, are regulated under the LGTOC.[54]

A. PLEDGE UNDER *"HABILITACIÓN O AVÍO"* OR *"REFACCIONARIO"* CREDIT AGREEMENTS

Originating in Mexico when it was still a Spanish colony, these are typically loans promoting production. They were once granted by banks to silver miners, the latter giving initially their tools and materials as security, and later the silver obtained. Now, these types of credit must be used to acquire raw materials and materials, and to pay wages and direct expenses of the enterprise.[55] These credits are secured by means of a pledge on the raw materials or materials acquired, and on the fruits, products or artifacts

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[52] See Garro, *supra* note 7 at 186.
[53] See *ibid.* at 175 & 176.
[54] See *LGTOC*, *supra* note 33, arts. 321-333; Garro, *ibid.* at 186 & 187.

obtained with the credit, even though they may be in the process of being produced or will only be produced sometime in the future.[56] Since possession of the collateral is retained by the debtor for use in his business, the pledge is perfected by registering the credit instrument in the Public Registry of Property and Commerce.[57]

The difference between the *habilitación o avío* and *refaccionario* credits is that *refacción* refers to preparation of the enterprise for production, while an *habilitación o avío* credit is used for the immediate process of production, the imminent action of producing the commercial items that the business provides for the marketplace.[58] The following two examples serve as an illustration: (1) a shoe factory takes a *refaccionario* credit to buy machinery and installations and subsequently uses an *habilitación o avío* loan to buy raw materials and pay employers to manufacture shoes; and (2) a farm uses a *refaccionario* credit to clear, drain and prepare farm land and then takes an *habilitación o avío* loan to purchase seed and fertilizer and actually plant the crop.[59]

A distinctive characteristic of the pledge in the *habilitación o avío* credit is that the encumbered property is transformed as a result of its employment in the production process and that it may then be disposed of during the regular course of business. To see how these types of credit function, let us introduce the following example. An *habilitación o avío* loan is granted to a carpenter, and under the terms of the agreement he grants security on the wood and nails he acquires with the funds. Of course he keeps such property and makes use of it to build a table, which in accordance with the law

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[55] See *LGTOC*, *ibid.*, art. 321.
[56] See *ibid.*, art. 322.
[57] See *ibid.*, art. 326.
[58] See Garro, *supra* note 7 at 187.
[59] See R. Cervantes Ahumada, *Títulos y Operaciones de Crédito*, 5th ed. (México: Editorial Porrúa, 1966) at 295.

becomes the collateral of the loan. Later on, he sells the table and the account receivable becomes the collateral, and when he is paid, the money becomes the collateral.

This credit agreement is sometimes not seen as an authentic security interest but rather as a right of preference, which it probably is since an important characteristic of a pledge is the right that the pledgee has to recover the encumbered goods from third parties (right to follow). However, with this type of credit the person buying the final product (the table in this example) does so free of any lien. This is confirmed by the LGTOC, which establishes that *habilitación o avío* credits, duly registered, shall be paid before *refaccionario* credits, even though subsequent in time, and both with preference over credits secured with a hypothec registered after them.[60] However, prior registered hypothec credits prevail over the security interest of the *refaccionario* lender, and the security interest shall continue to be attached to the collateral, notwithstanding its disposition by the debtor.[61] Moreover, the creditor may recover the pledged collateral of a *habilitación o avío* or *refaccionario* credit from anyone who has acquired the goods directly from the debtor and/or who knew or should have known of the security interest.[62]

On the other hand, with regard to a *refaccionario* credit agreement, this loan must be used to acquire farming tools, instruments and equipment, fertilizers, cattle or breeding stock, to grow seasonal or permanent crops, to develop lands for crops, to purchase or install machinery, or to construct the material works required for the promotion of the debtor's enterprise.[63] Part of the funds obtained with this credit may also be used to pay taxes or debts incurred during the previous year in connection with

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[60] See *LGTOC*, *supra* note 33, art. 328.
[61] See *ibid.*, art. 333.
[62] See *ibid.*, art. 330.
[63] See *ibid.*, art. 323.

the operation of the business concerning the exploitation or acquisition of immovables, such as lands or buildings, or the goods referred to in the preceding paragraph.

This credit is secured by pledge on the goods acquired or improved with the borrowed funds, and/or by a hypothec in case that the security is granted on immovables. In other words, in addition to present, pending, or future fruits and products, the *refaccionario* credit may be secured jointly or separately using the farms, constructions, buildings, machinery, equipment, furnishings, utensils, implements, or chattels owned by the debtor and destined to the loan-undertaking.[64]

As stated before, *habilitación o avío* and *refaccionario* loans are generally extended under the opening of a credit line against which the debtor may draw.[65] The contract, which may be a public or private document and which sets up the credit line secured by *habilitación o avío* or *refaccionario* collateral, must state the objective and duration of the loan, and the means of disposition of the credit lent to the debtor, and provide a precise description of the collateral plus all the other terms and conditions inherent in the contract. Moreover, the contract must be registered in the corresponding Public Registry in order to be effective against third parties from the "day and hour" of registration.[66]

The LGTOC considers the debtor as the trustee of all movable property pledged under the *habilitación o avío* or *refaccionario* credits, thus imposing civil and penal responsibility upon him in case he does not act with due care for their conservation.[67] This law also imposes a "monitoring requirement" on *habilitación o avío* or

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[64] See *ibid.*, art. 324.

[65] The borrower does not need to be the owner of the productive assets, provided that he is directly exploiting the enterprise or undertaking for which the credit is extended. For example, a lessee or assignee as well as an owner may avail himself of these credit devices.

refaccionario creditors, obliging them to ensure that the credit they extend is used for precisely those finalities determined in the contract. If they fail to do so and their credit is used to finance other aspects of the debtor's operation, such creditors lose their priority, but may rescind the loan contract and request immediate repayment of the debt plus interest as though the loan had come due. The burden is on the debtor-borrower, however, to show that the creditor had knowledge that the loan had deviated from the purposes outlined in the contract. [68]

The alleged disadvantage for these kinds of loans is that they are limited in scope and application because they are specially designed to be used by production enterprises. For some practicing attorneys this limitation seems excessively restrictive. In inventory financing, for instance, it would be impossible to use either the *habilitación o avío* or *refaccionario* mechanisms because nothing is produced; this seems to imply that the sale and distribution of goods at the wholesale or retail levels cannot be financed with these mechanisms. However, in practice, Mexican lawyers engaged in commercial financing frequently use these credit devices in non-production enterprises. Obviously, there is some difference of opinion as to whether these mechanisms are in fact limited to production enterprises, and therefore, it is clearly important to establish, when attempting to finance non-production enterprises (i.e., inventory based sellers), whether it is legally possible to use these credit devices in creating a secured loan.[69]

Moreover, both mechanisms may be secured with the "fruits and products" pending or obtained. It is not clear whether this "fruits and products" wording of the

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[66] See *ibid.*, art. 326.
[67] See *ibid.*, art. 329.
[68] See *ibid.*, art. 327, which provides that creditors may additionally designate an "intervener" to supervise the proper use of such credit, compelling the debtor to fully cooperate with him.

LGTOC is meant to encompass proceeds. It has been argued that by considering this wording and the historical context of the *habilitación o avío* and *refaccionario* credit agreements, it may be possible that "fruits and products" is limited to actual physical conversion of the original collateral (e.g., the transformation of apple seeds into apples), and does not include other types of transformations of the collateral (e.g., the transformation of inventory into accounts receivable).[70] Wilson-Molina identifies the problem as follows:

> The planting and harvesting of cotton provides another example of the problem. Cotton can be the direct fruit of *avío* and *refaccionario* loans for preparing the field and the purchase of seeds. Again, the question is obvious – will the cash and accounts receivable, and even garments produced with the cotton, be considered fruits or products of the loans? The answer to these questions is not very obvious under Mexican law. We should keep in mind that reform in this area of the law could clarify this matter.[71]

The overall scheme of *habilitación o avío* and *refaccionario* credits creates a powerful creditor with a security interest of surpassing priority, which may be exercised in bankruptcy as an absolute right.[72]

B. BAILMENT PLEDGE *(DEPÓSITO PRENDARIO MERCANTIL)*

The non-possessory pledge used by Mexican attorneys under Article 334(iv) of the LGTOC is known as the bailment pledge.[73] With this type of transaction, the debtor is required to transfer possession of the goods to the lender, at least symbolically. The lender, in turn, chooses a depository for the pledged goods. In other words, when the

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[69] See Wilson-Molina, *supra* note 11 at 8.
[70] See *ibid.* at 9.
[71] *Ibid.*
[72] For a more detailed explanation of these two credit agreements, the *habilitación o avío* and *refaccionario*, see Dávalos Mejía, *supra* note 30 at 785-795; see also O. Vásquez Del Mercado, *Contratos Mercantiles*, 3rd ed. (México: Editorial Porrúa, 1989) at 441-453.
[73] For a detailed explanation of the bailment pledge, see Dávalos Mejía, *ibid.* at 745-768; see also *Commercial Code*, *supra* note 32, arts. 75(xvii) & 332-339.

transaction requires that the debtor retain possession of the goods, for use or sale in the business enterprise, the lender will have to designate the debtor or somebody with close ties to the debtor (e.g., the president, or owner of the enterprise) as depository for the goods .[74]

One of the problems with the bailment pledge is that Article 334(iv)(v) LGTOC expressly requires that the goods be at the disposition of the lender when the goods given in pledge are to remain in an establishment (or warehouse) of the debtor, and that the keys to the establishment be surrendered to the lender. Therefore, are the pledged goods really at the disposition of the lender when the depository is for all practical purposes the same person as the debtor? Moreover, when the debtor intends to use and dispose of the pledged goods, are the goods still at the lender's disposition? The law does not provide a clear answer to these questions, thus limiting the use of this security device.[75]

Another problem exists because the LGTOC does not expressly require the registration of a bailment pledge. Nevertheless, many Mexican attorneys imply a common-usage registration. They assume that even though the law does not require it, registration in the Public Registry of Property and Commerce is necessary in order to give notice to third parties, as well as for the validity and effectiveness of the bailment pledge as a non-possessory device.[76] The disadvantage lies in the fact that a valid non-possessory pledge in the form of a secret lien may seem to exist, thus affecting the legitimacy of a creditor's priority.[77]

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[74] See Wilson-Molina, *supra* note 11 at 10.
[75] See *ibid.*
[76] Use and custom are recognized as lawful avenues for the creation of law. See *LGTOC* , *supra* note 33, arts. 2, 11 & 308.
[77] See Wilson-Molina, *supra* note 11 at 10 & 11.

Article 335 LGTOC provides that *in rem* rights of the pledge will follow the pledged good, even when the item is substituted for other goods, as long as the substitutes are of the same quantity, quality and species as the original goods. It is doubtful whether this provision considers proceeds (cash) and accounts receivable as being of the same species as the original good.[78]

However, this provision may be very useful in inventory financing, where the security interest shifts from one set of goods to another if they are fungible, or of the same species (kind of a floating charge on inventory). Nevertheless, it is also doubtful whether this mechanism can apply to the proceeds of the sale of inventory. Additionally, the law does not clarify what happens between the period of time when the good is converted into cash and when the cash is reconverted into inventory. Some Mexican attorneys have argued that the definition of fungible is very broad, and that as long as the original collateral and the second good have the same monetary replacement value, they will be considered fungible (i.e., a TV and an account receivable, which are not of the same species, may be considered fungible if they have the same debt-covering value).[79] However, the provisions of the LGTOC are certainly unclear in this regard.[80]

Furthermore, with respect to the registration of the bailment pledge in the corresponding Public Registry, attorneys are confronted with the problematic requirement of the law demanding a very strict and specific description of the collateral. Article 337 of the LGTOC requires a declaration expressing receipt of the goods given in pledge, including any data necessary for their "indubitable" identification (similar to pre-UCC

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[78] See *ibid.*

[79] See *CCDF*, *supra* note 16, art. 763, which states that movable goods are fungible if they can be replaced by others of the same species, quality and quantity.

[80] See Wilson-Molina, *supra* note 11 at 11.

serial number tests for identification). This detailed description of the collateral demanded by law may render the bailment pledge unworkable for creating the floating charge in inventory described previously. Moreover, must all goods that the lender has as a pledge be identified at the time of registration? This may be most troublesome in those cases where there are subsequent generations of the original collateral.[81]

C. BANKING PLEDGE *(PRENDA BANCARIA)*

The banking pledge, another method for creating a non-possessory security interest, is regulated under Article 69 of the LCI.[82] The law provides that this pledge may be granted by Mexican banking institutions for the acquisition of durable consumer goods. The concept of durable consumer goods is not clear; however, it apparently encompasses goods that are not consumed by ordinary usage. Mexican law does not provide a clear rule regarding what characteristics are to be found in these goods, nor the length of time that they must last. The goods will remain under the debtor's control and he shall be considered as depository of the same. In case of the debtor's default, the lender will automatically be allowed to repossess the goods under a summary judicial mechanism *(juicio ejecutivo mercantil)*.[83]

A clear disadvantage of this type of pledge is that Article 69 reserves its use exclusively for Mexican banking institutions. Consequently, this exclusive reservation prohibits sale creditors or asset based lenders from creating a non-possessory pledge in this form.[84]

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[81] See *ibid.* at 12.
[82] For a brief explanation of the banking pledge, see Dávalos Mejía, *supra* note 30 at 736, 777 & 778.
[83] See Wilson-Molina, *supra* note 11 at 12.
[84] See *ibid.*

Moreover, Article 69, like Article 334 LGTOC, does not require that the banking pledge be registered. Therefore, we encounter here the same problems mentioned before: (i) whether registration must in fact be carried out, (ii) whether the non-possessory security interest is valid and effective against third parties, triggering the lender's priority, and (iii) how to avoid creating a secret lien. Article 69 establishes that the banking pledge must be constituted in the same manner as provided by the LGTOC; therefore, we can assume that the common-usage registration requirement applies (Civil Code – Article 334 LGTOC – Article 69 LIC). Probably, this common-usage registration requirement extends to all non-possessory security interests. However, perhaps another explanation for the absence of a provision requiring registration of this pledge is that, since the lender retains title through the annotated invoice, there is no need for registration.[85]

D. CONDITIONAL SALES *(VENTA CON RESERVA DE DOMINIO; CLÁUSULAS RESCISORIAS)*

Conditional sales are generally regulated by the civil codes of each of the Mexican states and the Federal District.[86] Contingent installment sales account for more secured financing arrangements than any other device available under Mexican law. A typical example is when a consumer buying a car on credit in Mexico accepts a purchase contract, leaving title to the vehicle with the seller until all the obligations of the contract have been fulfilled. At the same time, the buyer usually signs a series of negotiable instruments (*letras de cambio* or *pagarés*) postdated to correspond to the dates of each installment payment.[87]

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[85] See *ibid.* at 13.
[86] See *CCDF*, *supra* note 16, art. 2312 (basic provision for conditional sales).
[87] See Furnish, *supra* note 7 ss. 37-22 & 37-23.

In fact, the term "conditional sale" does not translate directly into Spanish. A *venta condicional* is something quite different from any of the mechanisms by which a buyer acquires possession but not title;[88] nevertheless, this English term is used to cover *venta con reserva de dominio*,[89] *pacto con cláusula rescisoria*,[90] and variations on those classifications. "Mexican conditional sales most clearly correspond to purchase-money security interests in consumer goods under U.S. law."[91] A definition that may clarify the concept of a conditional sale under Mexican law is: "a contract whereby the buyer acquires title of the property only upon full payment of the price, notwithstanding the fact that he enters into possession of such property at the time of the celebration of the contract."[92]

A title-retention sale is a paradox in a civil law system like Mexico's, since the basis for ownership lies in title; however, Mexican law resolves the contradiction by reasoning that, although title transfer is necessary to effect a sale, the transfer need not occur until after all other aspects of the agreement have transpired. Hence, conditional sales are permitted in Mexico.[93] Individuals enjoy considerable freedom in entering into contracts, making it possible for the parties in a conditional sale agreement to postpone the transfer of ownership until the moment at which a future and uncertain event, such as payment of the price, takes place. Delivery of the object is not essential to the formation of the sales agreement, thus making it binding upon mere acceptance of the offer.[94] Any property right is susceptible to conditional sales, provided it is lawfully alienable and

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[88] See J. Gerber, "Secured Credit Devices in Latin America: A Comparison of Argentina, Brazil and Mexico" (Summer 1969) 23 Miami L. Rev. 677 at 704 [hereinafter "Secured Credit Devices"].
[89] See *CCDF*, *supra* note 16, art. 2312.
[90] See *ibid.*, art. 2310.
[91] Furnish, *supra* note 7 at 37-22.
[92] "Secured Credit Devices", *supra* note 88 at 704.
[93] See Furnish, *supra* note 7 at 37-22.

specifically identifiable.[95] A clause reserving ownership for the seller until final payment has been made would permit the recovery of the property from the buyer by taking advantage of the executory proceeding *(juicio ejecutivo)*, should the buyer default on any of the pre-stipulated partial payments that he had to make periodically.[96] However, because in Mexico possession of a movable is equal to title to it *(la possession vaut titre)*[97] with regard to third persons in "good faith", the seller who maintains title of the object but not its possession finds himself in a very poor position with respect to the rights of these third parties. Due to such principle, the conditional seller would then be unable to recover the alienated property from any third party purchaser in good faith unless the latter were given notice that the buyer was not entitled to dispose of the goods. Therefore, the effectiveness of the conditional sale as a non-possessory security interest in Mexico depends heavily upon the implementation of a workable method for giving notice of the seller's ownership to third parties. Mexico has laws authorizing conditional sales that provide for registration of the sales contract in the Public Registry[98] so as to protect the security interest of the conditional seller against third parties.[99] Therefore, any seller who fails to register the contract, a relatively simple procedure, is deemed to give away great leverage; there should be no reason for failing to register.[100]

The Mexican Civil Code specifically provides for the registration of conditional sales, granting the seller a right of action against third parties seeking the return of the goods sold. Conceptually, Mexican law distinguishes four different types of conditional

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[94] See *CCDF*, *supra* note 16, arts. 2248 & 2249.
[95] See *ibid.*, arts. 2310(ii); see also "Secured Credit Devices", *supra* note 88 at 707.
[96] See Furnish, *supra* note 7 at 37-30 & 37-31.
[97] See *CCDF*, *supra* note 16, art. 798.
[98] See *ibid.*, arts. 2310(ii) & 2312.
[99] See Garro, *surpa* note 7 at 188 & 189; see generally *CCDF*, *ibid.*, arts. 1951 & 2310-2315; see also "Secured Credit Devices", *supra* note 88 at 707.

sales: (1) an installment sale subject to rescission for missing payments *(venta con cláusula rescisoria)*, where title technically passes immediately to the buyer;[101] (2) a sale with reservation of title or ownership *(venta con reserva de dominio)*, where title is retained by the seller after delivery of the goods until the purchase price has been paid;[102] and commercial sales *(compraventas mercantiles)*, such as (3) a commercial installment sale (rescission-clause)[103] and (4) a commercial sale with reservation of ownership (title-retention clause).[104]

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[100] See Furnish, *supra* note 7 at 37-25.

[101] See *CCDF*, *supra* note 16, art. 2310 (providing that installment sales contracts of immovable property or identifiable movable property that contain a clause permitting the seller to rescind the contract in the event that any installment is not paid shall be effective against third parties if properly registered in the Public Registry).

[102] See *ibid.*, art. 2312 (makes Article 2310 applicable to sale agreements in which it is stipulated that the seller shall retain title until the full price is paid).

Although both the Mexican installment sale and sales with reservation of title-ownership both contain rescission clauses in the contract and are somewhat similar, there are some important differences between them. While in the first title technically passes to the buyer upon receipt of the goods in question, in the second title is retained by the seller until all the payments are made. This noticeable difference leads to other distinctions, which arise regarding (i) the rights in the collateral retained by the debtor, (ii) the risk of loss and (iii) the ranking of the security interest.

Regarding (i), a buyer under a sale with reservation of ownership cannot legally sell the goods since he does not own them; moreover, if he sells them, he would be subject to penal and civil liabilities in addition to the seller's right to repossess the goods. Therefore, if the parties intend that the buyer resells the goods before paying the purchase price, it would be recommended to use an installment sale device due to the advantage that by such method the buyer immediately becomes the owner of the goods.

Regarding (ii), the risk of loss remains with the seller under a sale with reservation of title or ownership and shifts to the buyer under an installment sales contract. However, the risk of loss aspect is generally covered by the sales agreement, which typically stipulates that either the buyer accepts the risk of loss (See *CCDF*, *ibid.*, arts. 2017(v), 2315 & 2468; *Commercial Code*, *supra* note 32, art. 377), or procures insurance and names the seller as beneficiary. Mexican law generally presumes against the party in possession.

Regarding (iii) as to the priority of the security interest in the event of the buyer's bankruptcy, the seller with reservation of title or ownership is given a preferred status because the goods never became part of the buyer's estate and are consequently free from the claims of the buyer's creditors (See Garro, *supra* note 7 at 193). Default by the debtor shall constitute a non-commercial bankruptcy *(concurrencia)* under Mexico's Civil Code (See *CCDF*, *supra* note 16, art. 2965), and the creditor's claim would have to compete against other claims and therefore have a place under the seven recognized categories of creditors under the Civil Code (See Furnish, *supra* note 7 at 37-27).

[103] See *Commercial Code*, *supra* note 32, arts. 371, 372 & 2-4 (unless both parties of the contract of sale are merchants engaged in commerce, it is likely that the provisions of the Civil Code will govern).

[104] See Garro, *supra* note 7 at 192.

E. COMMERCIAL INSTALLMENT SALES *(COMPRAVENTA MERCANTIL)*

Commercial sales are additionally regulated by the Commercial Code, which applies throughout the nation and takes precedence over the local civil codes where there is any conflict of provisions. A commercial sale, unlike a general conditional sale, is ordinarily one that is entered into for the primary purpose of speculation or profit.[105] To be considered as a commercial transaction, an installment sale must qualify as a commercial act under Article 75 of the Commercial Code.[106] Moreover, unless both parties to a transaction are merchants engaged in commerce, it is likely that civil rather than commercial law provisions will prevail.[107] The Commercial Code permits both title-retention and rescission-clause installment sales without specifically mentioning them.[108]

F. MOVABLE HYPOTHEC *(HIPOTECA MOBILIARIA)*

Although the pledge in its civil and various commercial manifestations and the title-retention and rescission-clause approaches to installment sales form the major bases for secured financing on movables in Mexico, there are other alternatives to those devices

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[105] See "Secured Credit Devices", *supra* note 88 at 707.

[106] See *Commercial Code*, *supra* note 32, art. 75.

[107] See Furnish, *supra* note 7 at 37-29.

[108] The Commercial Code provides enforcement for all licit stipulations the parties may have agreed upon (See *ibid.*, art. 372), and additionally states that either commercial party in compliance may rescind against a party in default (See *ibid.*, art. 376). The Commercial Code also provides for a special executory proceeding *(juicio ejecutivo)* (See *ibid.*, arts. 1391-1414), formally distinct from that found in the Civil Code. In fact, while the time periods differ somewhat, the basic procedure is the same as the civil proceeding provided under the Code of Civil Procedure for the Federal District or for any other Mexican state (See *CCDF*, *supra* note 16, arts. 2323-2326, 2893, 2898, 2916-2918, 2925 & 2927).

"Risk of loss likewise regularly is covered by the sales agreement. The Commercial Code imposes risk of loss on the party who has physical or legal possession of the goods unless some other party's negligence creates liability to indemnify the holder" (See *Commercial Code*, *ibid.*, art. 377; Furnish, *supra* note 7 at 37-30).

The scheme of priorities regarding commercial installment sales differs substantially under the Commercial Code from that of the Civil Code. In the Commercial Code, creditor priorities fall into five brackets set out by its Bankruptcy Law, and commercial installment sellers regularly belong to the third class (See *LQSP*, *supra* note 36, arts. 261 & 264). As explained before, so long as the seller has exercised minimum diligence and registered the agreement in the Public Registry of Property and Commerce, he should have a fair chance to collect the debt out of the debtor's assets (See Furnish, *supra* note 7 at 37-30 & 37-31).

for secured financing that one should contemplate. One of these is the movable hypothec.[109]

The Civil Code is the applicable law for the hypothec, apparently without regard to circumstances of a commercial nature that surround the transaction.[110] Past civil codes limited the hypothec to immovable property; however, the present code implies that movables can also be hypothecated if they are specifically identifiable.[111] A hypothec *(hipoteca)* is now defined by the Civil Code as a security arrangement involving property that is not delivered to the creditor and which, in the event of non-performance of a principal obligation, gives such creditor the right to be paid out of the value of that property with priority as established by law.[112]

Like title-retention sales, movable hypothecs also give rise to a paradox in Mexican civil law. However, this device does exist, conceptually in the same vein as the pledge without dispossession (non-possessory pledge).[113] Now that we know that movables are allowed by law to be hypothecated, the only difference between the hypothec and the traditional pledge is the debtor-creditor possession of the object given as collateral in the secured transaction.[114] A movable hypothec is essentially the same as a non-possessory pledge.[115] Nevertheless, the movable hypothec implies greater

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[109] See *ibid.* at 37-33.
[110] See *CCDF*, *supra* note 16, arts. 2893-2943.
[111] See *ibid.*, art. 2895 & 2898; see also "Secured Credit Devices", *supra* note 88 at 699 & 670.

Any movable property susceptible to alienation may serve as collateral under a hypothec, except when otherwise expressed by law. Pending produce (*i.e.*, crops or goods in process) and future profits when separated from the property which produces them are some of the assets that the law establishes as unsuitable for a hypothec. In addition, movables permanently affixed to an immovable may not be hypothecated independently. Finally, assets involved in pending litigation are not permitted to be hypothecated either, unless the litigation is registered and the creditor has knowledge of such proceedings.

[112] See *ibid.*, art. 2893; see also "Secured Credit Devices", *supra* note 88 at 699.
[113] See Furnish, *supra* note 7 at 37-33.
[114] See *CCDF*, *supra* note 16, arts. 2858 & 2893.
[115] In Mexico movable hypothecs and civil non-possessory pledges are regulated by the Civil Code and consequently are applicable to civil or non-commercial transactions. Nevertheless, nothing prevents

formalities[116] (required for real property hypothecs) and controls for its perfection and enforcement,[117] such as special registration and foreclosure procedures, which consequently give less favorable rights and remedies (including rank) to the creditors.[118] Moreover, another disadvantage of the movable hypothec, as opposed to the non-possessory pledge, is that the security interest of the creditor generally does not extend to the proceeds of the collateral. For these reasons, movable hypothecs in Mexico are less desirable to a secured party than a non-possessory pledge.[119]

Despite these disadvantages, a movable hypothec can be useful in several situations. For example, the definition of real property provided by the Civil Code states that it shall extend to fixtures (united with the immovable in a fixed manner, so that any separation is impossible without damaging the realty or the movable item itself),[120] objects of art, machines used to work a farm or plant, animals, agricultural inputs, and a comprehensive list of other items, giving the creditor a strong hold on the debtor's real property and accouterments.[121]

G. THE INDUSTRIAL HYPOTHEC *(CRÉDITO HIPOTECARIO INDUSTRIAL)*

The "industrial hypothec" *(crédito hipotecario industrial)* is another mechanism, regulated under Article 67 of the LIC, that creates hypothec-rights on personal property.

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merchants from agreeing on a movable hypothec or non-possessory pledge pursuant to the provisions of the Civil Code. But since in most cases the creditor's concerns end up turning to priorities in case of debtor's insolvency, it is likely that merchants would choose a commercial non-possessory pledge such as the *habilitación o avío* or *refaccionario* credit operations, whose ranking status is more favorable than the one granted under a movable hypothec. See *LGTOC*, *supra* note 33, art. 328; see also Furnish, *supra* note 7 at 37-34; *Commercial Code*, *supra* note 32, art. 2; *LQSP*, *supra* note 36, art. 263.

[116] See *CCDF*, *supra* note 16, arts. 2917, 2317, 2320 & 730.

[117] See *ibid.*, arts. 2925, 2927, 2916, 2323-2326 & 2918.

[118] See *ibid.*, arts. 2323-2326, 2893, 2898, 2916-2918, 2925 & 2927.
See also Furnish, *supra* note 7 at 37-33.

[119] See *ibid.*, art. 2898(i); see also Garro, *supra* note 7 at 186; "Secured Credit Devices", *supra* note 88 at 699 & 700; Furnish, *supra* note 7 at 37-33.

[120] See *CCDF*, *ibid.*, art. 750(iii).

[121] See *ibid.*, art. 750; Furnish, *supra* note 7 at 37-33 & 37-34.

The LIC provides that the industrial hypothec will encumber the "complete unit" of an industrial, agricultural or service enterprise. The law establishes that the industrial hypothec will extend to all assets of the firm, including: (i) the concession or license, or both, (ii) all real estate and personal property used by the enterprise in its operations, (iii) all money in the current account, (iv) accounts receivable, and (v) all credits in its favor originated by the business operation. Moreover, the industrial hypothec provides that the encumbrance over the assets of an enterprise shall not prejudice the enterprise's ability to use, dispose of and substitute its assets in the ordinary course of business. The lender must permit the operation, use and exploitation of the assets in accordance with the expected ordinary use of each. However, the lender may oppose the sale or additional encumbrance over the assets and can oppose mergers with other companies if such actions will jeopardize his security interest.[122]

This feature of the industrial hypothec can be considered as a device that brings more confusion to the secured financing framework described herein.[123] The problem presented by the industrial hypothec is twofold: (1) like the banking pledge, its use is reserved for financial institutions, and (2) since it stems from the traditional concept of a real estate hypothec, a loan secured by an industrial hypothec is usually expected to be secured primarily with immovable (real) property. Although in the industrial hypothec it

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[122] See Wilson-Molina, *supra* note 11 at 13.

[123] See G.Colín Sánchez, *Procedimiento Registral De La Propiedad*, 3rd. ed. (México: Editorial Porrúa, 1985) at 408. The term "industrial" is considered to mean: (i) that the credit extended is only used for industrial finalities (production), where virtually all of the property of a given enterprise is secured, including goods produced after the date of the hypothec; and/or (ii) that the security interest may only affect the estate of the accredited industrial enterprise, without prejudice of establishing any of the additional security interests permitted by law.

is not essential that real property be included, currently most of these mechanisms do encumber real property.[124]

H. GUARANTEE TRUST *(FIDEICOMISO DE GARANTÍA)*

The guarantee trust[125] consists of two elements: (1) the trust *(fideicomiso)* itself, and (2) the security mechanism, which is generally a hypothec-type of interest in real estate; however, it may also include, to a lesser extent, personal property. While this trust mechanism can be used in many different ways, Article 346 of the LGTOC limits the trust to a determinable lawful use. The guarantee trust is composed of three parties: (1) the debtor-trustor *(fideicomitente)*, (2) the lender-beneficiary *(fideicomisario)*, and (3) the trustee *(fiduciario)*, which is always a Mexican financial institution.[126]

Under this mechanism, the trustor secures the preferential payment of a loan. The guarantee trust is created by transferring legal title from the trustor to the trustee. If the debtor-trustor defaults on the loan, (i) the trustee will be compelled by the agreement to sell the collateral and pay the lender-beneficiary with the proceeds, or (ii) it is also possible, if agreed to by the parties, that title to the trust property will revert automatically to the lender, who shall then enjoy full use of the property.[127]

Some Mexican scholars argue that thanks to the extraordinary flexibility of the guarantee trust, it is superior to the hypothec and the pledge.[128] One of the main benefits to this security device is that, at least theoretically, it is possible for the trustee to execute on the collateral (enforcement proceedings) without having to resort to the judicial

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[124] See Wilson-Molina, *supra* note 11 at 13 & 14. See also Furnish, *supra* note 7 at 37-34, which states that "[n]othing under Mexican law comes closer to the floating lien as it is used in the United States".
[125] For a detailed explanation of the guarantee trust, see Dávalos Mejía, *supra* note 30 at 867-871.
[126] See Wilson-Molina, *supra* note 11 at 14.
[127] See *ibid.*
[128] See Rodríguez Rodríguez, *supra* note 30 at 243.

system. However, the parties must expressly establish this execution power in the trust instrument.[129]

Although the guarantee trust presents some benefits, it is not without its disadvantages. For example, apparently this device reduces court involvement in the repossession and sale of the collateral. However, in reality, the trust has resulted in a lot of litigation and is at times more difficult, expensive and time-consuming than repossession via the judicial executory proceeding *(juicio ejecutivo mercantil)*. Some of the most common issues litigated in Mexican courts are: (i) whether the guarantee trust was created for a legal purpose, as provided by Article 346 of the LGTOC; (ii) whether the guarantee trust is a mechanism that can transfer legal title or whether it only transfers temporary title; and (iii) whether it is possible for the trustee (financial institution) to act as a judicial body when it is not.[130]

As previously stated, although used to a lesser extent, personal property can also be used as security under this mechanism; however, using personal property creates the same problems as the commercial pledge. For instance, in a guarantee trust transaction, the goods must be placed in the immediate possession of the trustee. Therefore, this transaction will not work in situations of financing inventory or manufacturing equipment, where the debtor-trustor needs to retain possession of the collateral. Furthermore, there is no provision in the law requiring the registration of a guarantee trust. Again, this creates the possibility of creating a secret lien. This is the reason why, in practice, some trusts are registered.[131]

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[129] See Wison-Molina, *supra* note 11 at 15.
[130] See *ibid.*
[131] See *ibid.*

I. FINANCIAL LEASE *(ARRENDAMIENTO FINANCIERO)*

Another way to create a non-possessory security interest under Mexican law is through a lease with option to purchase contract *(arrendamiento financiero)*, also called a financial lease or lease-sale agreement. The financial lease offers the lessor-creditor an expeditious and cheap form of generating a security interest.[132] Much personal property, such as automobiles, furniture, refrigerators, television sets, radios, etc. are sold under lease with option to purchase contracts.[133]

This secured transaction consists of: (i) a lessee who is obliged to pay a specified sum as rent, and who has the option to become the owner of the leased movable at the expiration of the lease contract; (ii) an option to buy, which is usually put together with another clause providing that, if the lessee defaults, rescission will take place automatically; (iii) title of the goods, which remains with the secured creditor-lessor, while possession is retained by the debtor-lessee; and (iv) the right of the creditor to immediate recovery of the goods, without the need for judicial action, if the lessee defaults on any of his monthly rent payments.[134]

A lease with option to purchase agreement is permitted and perfectly valid in Mexico. However, Mexican courts are not likely to allow the parties the use of this transaction in order to avoid the formal requirements and restrictions available under the sales with reservation of ownership or installment sales with rescission clauses. Moreover, the courts often regard a lease with option to purchase as a "simulation" *(simulación)*, since the parties' express intent to enter into a financial lease hides the true intent to enter into a secured transaction. Simulated acts entered into in order to damage

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[132] See Garro, *supra* note 7 at 195.
[133] See Folsom, *supra* note 49 at 489 & 490.

someone's rights or that have an illicit purpose are subject to avoidance under the Civil Code.[135] If, under the financial lease, the lessee is granted a true option to purchase (not mandatory), and the sum required to be paid while exercising the option is substantial (not negligible), then the transaction is considered as a true lease by the courts.

> To secure full recognition by the courts of the lease with option to purchase contract it is essential that the contract be exactly what the name implies and no more. It must be a bona fide lease entitling the lessee to the use and possession of the merchandise. The option to purchase must be carefully drawn and should not be automatic. The option to apply the rent on the purchase price must lie exclusively with the lessee.[136]

However, even if the transaction is considered as a true lease, its effectiveness as a secured transaction depends on the means available to the lessor for serving notice of his legal ownership to third parties (bona fide purchasers or creditors of the lessee). Once again, the underlying reason for this is that possession of a movable is equivalent to title to it *(la possession vaut titre)*. In Mexico, no registration is necessary to perfect the lessor's claim against third parties;[137] therefore, only actual knowledge of the financial lease will preclude a third party from acquiring good title to the property from the lessee. As a result, often the lessor can only recover the property if it is still in the defaulting lessee's possession; recovery from a third party in good faith is unobtainable.[138]

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[134] See Garro, *supra* note 7 at 195.
[135] See *CCDF*, *supra* note 16, arts. 2180-2184.
[136] Folsom, *supra* note 49 at 490.
[137] See Furnish, *supra* note 7 at 37-36.
[138] See Garro, *supra* note 7 at 196.

IV. CONCLUSION

This survey of existing Mexican security devices has identified the following general weaknesses: (i) lack of a standard security device, (ii) lack of a single method for perfection, and (iii) lack of a systematic structure to regulate security interests under one law. Part Two will suggest ways of reforming Mexico's regime in order to correct these weaknesses by adopting principles from the contemporary commercial lending marketplace according to American and Canadian legislation and practice.

PART TWO

FEATURES OF MEXICAN PERSONAL PROPERTY SECURITY LAW IN NEED OF REFORM

I. Article 9 of the Uniform Commercial Code, Book Six of the Civil Code of Quebec & the Canadian Personal Property Security Acts as Models for Reform

Throughout Part One, this thesis discussed the major types of possessory and non-possessory security interests in Mexico. According to the law professors and legal commentators cited throughout this study, the current legal framework of security interests in personal property in Mexico is archaic and inadequate for modern financing needs, hindering the extension of credit and increasing its cost.[139] Therefore, current legal frameworks that function well and are "modern", such as Article 9 of the Uniform Commercial Code (UCC) of the United States, Book Six of the Civil Code of Quebec (CCQ), and the Canadian Personal Property Security Acts (PPSAs), could serve as models for reform in Mexico. These models would surely provide Mexican legislators with the necessary tools to achieve reform within the field of secured transactions, since they contain a number of appealing features.

Dr. Boris Kozolchyk states that the UCC, on which the Canadian PPSAs[140] are based, "has fostered the development of the world's largest and most active commercial

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[139] See Garro, *supra* note 7 at 157.

> Kozolchyk, *supra* note 5 at 1:
> Large scale distribution of goods and services requires the availability of a reasonable priced credit for manufacturers, producers, wholesalers, retailers and consumers. For borrowers in the emerging entrepreneurial class, access to credit depends on their ability to pledge their productive assets as loan collateral. As a result, a balance must be struck between the debtors' need to use such assets to their fullest income-generating potential and their creditors' need to seize and sell the collateral quickly and inexpensively in the event of default. A legal system which successfully balances these interests will, to the extent allowed by purely economic considerations, keep interest rates at an affordable level.

[140] We should be aware, however, that although the PPSAs embody most of the basic concepts and much of the detail of Article 9, the Canadian legislation is not simply a carbon copy of it; there are many significant differences in substance and detail. Nevertheless, the similarities between the Canadian PPSAs and Article

and consumer credit markets" and that "it did so by shaping rules inspired by the following key principles of the contemporary commercial lending marketplace":

1. The concept of a generic security device, the "security interest" and the "hypothec";[141]
2. "Any asset for which buyers or lenders are willing to pay value may serve as collateral;
3. The collateral may not exist a the time of the loan, nor must it be tangible;
4. The debtor need not be the owner of or have title to the collateral; the debtor simply must have "rights" (meaning possessory rights) to the collateral;
5. Even though the debtor may sell, use or otherwise consume the collateral in its possession, a creditor's security interest is enforceable against the "products" and "proceeds" of the original collateral, and against its replacements;
6. Security interests in the same collateral may be held by different creditors, concurrently or at different times as long as these claims are assigned different priorities;
7. The enforceability of creditors' interests in collateral against third parties depends upon the giving of effective notice (publicity) of such interests;
8. In some instances notice is best given by the creditors' possession of the collateral and, in others, by a simple, inexpensive and easily accessible registration of the security interest;
9. The registry best suited for personal property secured transactions is not a registry of collateral, but of debtors; (only when an item is very valuable and subject to serial number identification does a registry of collateral make sense); and
10. In the event of default, the realization of the creditors' claims to movable collateral (since it is often subject to rapid depreciation) must be as quick and inexpensive as possible while adequately protecting debtors' rights;"[142] and
11. A system where all security transactions in personal property and fixtures are regulated in a single code in a coherent and systematic manner.[143]

However, even the presence of such features does not mean that the process of adaptation will be easy or quick in the Mexican context, as intellectual habits cultivated

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9 are much more numerous than the differences. Moreover, we should also be aware that not all PPSAs are the same. For a detailed explanation of the substantive differences between recent Canadian PPSAs and Article 9, see R.C.C. Cuming, *Canadian Developments in Personal Property Security Law* in *Secured Transactions*, U.C.C. Serv. [Bender] (1985) ch. 5D [hereinafter "Canadian PPSL"].

[141] The hypothec of the *Code Civil du Québec* (CCQ, Civil Code of Quebec, or Quebec Civil Code) is the conceptual and functional equivalent of the security interest of the PPSAs and Article 9. The hypothec displaces most, but not all, other types of financing devices used in Quebec prior to the implementation of the 1991 Civil Code - whose the hypothec provisions came into force on 1 January 1994. See R.C.C. Cuming, "Article 9 North of 49°: The Canadian PPS Acts and the Quebec Civil Code" (1996) 29 Loyola of Los Angeles L. Rev. 971 at 986 [hereinafter "Article 9 North of 49°"].

[142] See Kozolchyk, *supra* note 5 at 2.

[143] See *ibid.*

over many years cannot be easily changed.[144] Moreover, when adopting some of the approaches contained in Article 9, the CCQ and the PPSAs with the aim of modernizing Mexico's personal property security law, we must bear in mind that this will not solve all the political and economic problems associated with the lack of financing capital and the slow growth of credit in Mexico.[145] It shall help, however, the financing relationship between debtors and creditors "by placing at the disposal of merchants and traders alternative and simple means of financing commercial transactions", thus creating a legal framework likely to increase the possibility of obtaining sources of capital that otherwise would be unavailable.[146]

This proposed reform should always be regarded in parallel with the needs and business practices particular to Mexico's developing economy and civil law system.[147] For example, adopting Article 9's basic features is not and will never be as simple for Mexico as it was for some of the common law provinces of Canada, where such adoption

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[144] See J.S. Ziegel & R.C.C Cuming, "The Modernization of Canadian Personal Property Security Law" (1981) 31 U.T.L.J. 249 at 250-251.

Prof. Jacob S. Ziegel of the University of Toronto is considered by some Canadian legal scholars to be the "father" of modern Canadian personal property security law. He was one of the pioneers in "carrying the torch" of personal property security law reform in Canada. He was the chairman of the Canadian Bar Association's "MUPPSA" Committee and a member of the Ontario Minister's Advisory Committee on the Personal Property Security Act.

Prof. Ronald C.C. Cuming of the University of Saskatchewan College of Law was the Coordinator of the Secured Financing Project at the National Law Center for Inter-American Free Trade (NLCIFT) in Tucson, Arizona. He was one of the chief architects of the Canadian PPSA (Alberta, BC, and Saskatchewan). He is now an advisor to the European Bank for Reconstruction and Development (EBRD) for the development of a Model Law on Secured Transactions, the European Community, the World Bank and the United Nations.

[145] See B. Kozolchyk, "Law and the Credit Structure in Latin America" (1967) 7 Va. J. Int'l L. 1 at 36-46 [hereinafter "Law and Credit Structure"].

[146] See "Reform and Harmonization", *supra* note 8 at 4.

[147] Any endeavor in the field of modernization and harmonization of security interests must be grounded in empirical evidence and be responsive to carefully considered policy goals. See D.E. Allan, "Credit and Security: Economic Orders and Legal Regimes" (1984) 33 Int'l & Comp. L.Q. 23.

As Goode and Gower have said with regard to the "exportability" of Article 9: "One of the most impressive features of the work of Karl Llewellyn and his colleagues was that it was based on detailed and lengthy research into American business practices. The last thing that they would have wished is that it should be extended to other countries without equally thorough research into the practices prevailing

was still not easy and remains unfinished despite their common law tradition and socioeconomic situation.[148] The province of Quebec, which follows a civil law tradition and where the regime on secured transactions is regulated under its Civil Code, is more similar to Mexico's personal property security law scheme and thus easier to understand if regarded as a model for adoption. To some extent, this study examines Quebec's security law regime under the reformed Civil Code of 1994, and the way Quebec confronted the common law influence on secured transactions that began in the United States through Article 9, passed through several common law Canadian provinces under the proposed *Draft Model Uniform Personal Property Security Act* (MUPPSA)[149] and then moved surprisingly through the province of Quebec.[150]

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there." R.M. Goode & L.C.B. Gower, "Is Article 9 of the Uniform Commercial Code Exportable? An English Reaction" (1969) Aspects of Comparative Commercial Law 298 at 325.

[148] As noted by Professor Cuming, Canada presents conditions parallel to those of the United States with regard to the harmonization of the law of security interests at a national level. Moreover, Canada also has a federal form of state in which the field of personal property security law is the competence of the provincial legislatures. In Canada, harmonization of the law of security interests has not yet been achieved, but it seems to be well under way. See R.C. Cuming, "National and International Harmonization: Personal Property Security Law" (1984) in Commercial and Consumer Law from an International Perspective, Papers from the Conference of the International Academy of Commercial and Consumer Law, Castle Hofen, Austria, 17-22 July, 1984 (D.B. King ed., 1986) at 471-517 [hereinafter "National and International Harmonization"].

Ziegel & Cuming, *supra* note 144 at 288: "While Canadians have adopted Article 9 concepts as a basis on which to rebuild Canadian law, it is clear that they have refused to accept Article 9 as the final word on all matters relating to personal property security law. Differences in history, economic conditions, commercial practices, and social outlook are reflected in the Canadian legislation and proposals for reform. However, the differences are not fundamental...."

[149] In 1970, the Uniform Law Conference of Canada and the Commercial Law Section of the Canadian Bar Association approved and adopted a Revised Draft Uniform Personal Property Security Act. The title of the act was subsequently changed to Model Uniform Personal Property Security Act (MUPPSA), and the name of the committee was adjusted accordingly, becoming the MUPPSA Committee.

However, in light of Canadian developments since 1970, both sponsoring organizations co-sponsored the replacement of the MUPPSA by the Uniform Personal Property Security Act (UPPSA) in 1982. This UPPSA of 1982 was a considerably more detailed and comprehensive than was the MUPPSA. The UPPSA was designed to be a model for Canadian provincial personal property security legislation and, as such, a vehicle for securing interjurisdictional harmonization of this area of the law. See Uniform Law Conference of Canada, *Proceedings of the 64th Annual Meeting* (1982) app. X at 358-420 J.S. Ziegel, "The Uniform Personal Property Security Act 1982" (1982-83) 7 C.B.L.J. 494 [hereinafter "UPPSA1982"]. For an explanation of some of the differences among the various Canadian PPSAs, see R.C.C. Cuming, "Personal Property Security Law: The New Kids On The Block" (1991) 19 C.B.L.J. at 191-212 [hereinafter "The New Kids On The Block"].

As Professor Garro states:

> [T]he experience gathered in Canada and the United States with the introduction of Article 9 in Quebec and Louisiana serves as an example of the adaptability of the conceptual framework of Article 9 with the civil law tradition. .... The experience of Louisiana with the adoption of Article 9 and of Quebec with the proposed revision to the articles on secured transactions of the Civil Code is of crucial importance to assess the prospects of modernization of personal property security law in countries which do not belong to the common law tradition.[151]

He continues:

> A glance at the language of Article 9 reveals a highly technical structure of security interests too distinctive for an easy common law - civil law comparison. Beneath that technical language, however, there is a simple and practical approach to secured financing whose skeletal contours are quite in line with civil law analysis.[152]

Since increasing credit activity is bound to have a major impact on the region's much needed social and economic development, modernizing the law of secured transactions may be viewed as a matter of necessity for promoting credit, rather than

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Both Acts, among others, symbolize Canadian efforts to harmonize provincial legislation in personal property secured financing. See J.S. Ziegel, "The New Provincial Chattel Security Law Regimes" (1991) 70 The C.B. Rev. 681 at 697-699 [hereinafter "New Provincial Chattel Security Law Regimes"].

[150] "Article 9 North of 49°", *supra* note 141 at 973-974:

> The situation in Quebec, while not fundamentally different in result from the rest of Canada, was in greater need of conceptual reform because of the contradictory features of Quebec commercial law: the refusal to recognize the possibility of a hypothec of movables, on the one hand and, on the other, the urgent need for security devices to facilitate non-possessory business asset financing. [...] Again Article 9 provided an approach for the drafters of the Civil Code through which much of the patchwork of security devices with their anomalies and inadequacies could be eliminated and replaced with a much more coherent system for the regulations of secured financing. However, while Article 9 provided a legislative pattern for common-law jurisdictions, it could only provide an approach for Quebec. Legislators in that province were not prepared to be seen as abandoning civil-law concepts and terminology. What was attempted was the creation of civil-law parallels to the central features of the PPSA's and Article 9.

[151] "Reform and Harmonization", *supra* note 8 at 8.

[152] *Ibid.* at 9. "There is much in the UCC that seems more consistent with the civil law than with the common law that governs transactions not covered by the Commercial Code in states that have adopted it." *Comments*, "Security Rights in Movables Under the Uniform Commercial Code and Louisiana Law - A Transactional Comparison" (1966) 40 Tul. L. Rev. 747 at 751.

H.R. Sachse, "Report to the Louisiana Law Institute on Article Nine of the Uniform Commercial Code" (1967) 41 Tul. L. Rev. 505, 785 at 844: "It seems clear that on the plane of property law and contract the Uniform Commercial Code is sufficiently self-contained to be able to work effective on either and underlying ground of civil law or common law."

mere convenience.[153] Mexico is and must face these changes if it wants to keep pace in its regional economic integration under NAFTA with such economically powerful countries as the United States and Canada.[154]

Rather than discussing every possible issue, Part Two of this thesis addresses the key problems that must be dealt with so as to reshape and modernize Mexico's personal

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[153] "Eventually, law reform may contribute to the promotion of much needed credit growth in developing countries." "Reform and Harmonization", *supra* note 8 at 16 & 17.

[154] In his report for UNCITRAL, Professor Drobnig notes:

> A careful observer of the present scene of international trade may detect certain trends which enable a forecast of likely developments in a coming decade or two. Since both the volume, and credit-demand in international trade is undoubtedly likely to increase, the need for security interests as a protective device will grow. This growth will be particularly noticeable within the various regional economic unions or compacts.

Drobnig, *infra*, note 498, ss. 3.1.2. at 212.

> Harmonization efforts might appear justified only among jurisdictions with significant commercial ties or among those sharing common borderlines. .... Those jurisdictions primarily interested in a legislative reform of domestic personal property law may pursue the goal of harmonization in order to reassess and, if necessary, re-elaborate traditional principles and mechanisms. ... harmonization of personal property security law in Canada and the United States was brought up ... by the need to modernize the domestic laws of the participating jurisdictions.

"Reform and Harmonization", *supra* note 8 at 14.

"Legislators interested primarily in reform of domestic personal property security law may use as a basis for reform the principles and concepts of a system of law existing in another jurisdiction." "National and International Harmonization", *supra* note 148 at 483.

Kozolchyk, *supra* note 5 at 1:

> [T]housands of security interests, representing millions of dollars in loan, are registered in Canada and the United States every day. While Mexican law provides various forms of non-possessory liens in personalty, ... , they are not designed for use in a modern commercial setting to finance and secure, for example, a merchant's inventory or his accounts receivable. In fact, registrations of personal property secured transactions in Mexico City, one of the world's largest cities, amount to no more than a handful per day. It is not surprising then that the average cost of commercial and consumer loans in Mexico is often three times higher than in Canada or the United States.
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> The impact of this credit cost differential on the NAFTA's long-term success and on Mexico's ability to develop its internal and external markets is quite significant. For example, how can Mexican small to mid-size businesses compete with Canadian or U.S. merchants who pay much less for their commercial credit? And if commercial credit is prohibitively expensive and unavailable to the Mexican merchant, what credit terms, if any, can be extended to his customers? Finally, how can a Canadian and U.S. investor open a manufacturing plant or a distribution center in Mexico if, as a result of the inadequacies and uncertainties of Mexican secured transactions law, its home bank is unable to secure the loan needed to finance the start-up costs using assets located in Mexico?

property security law.[155] "Progress may be accomplished in stages, each devoted to a specific aspect of personal property security law."[156] However, at this point in time it is impossible to predict the degree of success for such an undertaking due to the fact that law reform is more likely to depend on the economic and political climate of a country and the role played by its finance industry than on the intrinsic quality of legal draftsmanship.[157]

II. Characterization of Security Interests

As we have seen throughout Part One, Mexico is a country with an ample array of personal property security devices. The gradual creation of security interests had a negative effect on secured financing, making personal property security law fragmented, complex, confusing and even sometimes incoherent. Under this perspective, the first issue that arises and which is addressed in this section is whether such traditional forms of security interests should be maintained or whether the Mexican regime on secured transactions should be abandoned in favor of a unified concept of security interest flexible enough to expand its scope to include any type of secured transaction in personal property, as is the approach taken under Article 9, the PPSAs and the CCQ.[158]

In Mexico, transactions that are essentially similar in nature are regularly treated in different ways. This is true of commercial and non-commercial secured transactions regarding, for example, the form the parties choose for their transaction (e.g., movable

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[155] Some of the issues to be discussed correspond with those that UNCITRAL considers essential policy choices to be made in the modernization of personal property security law. See "Report of the Secretary-General: Issues to be Considered in the Preparation of Uniform Rules (A/CN.9/186)" (1980) 11:2 UNCITRAL Y.B. at 89-95 [hereinafter "UNCITRAL 11"]. For a discussion of similar issues see also Cuming "National and International Harmonization", *supra* note 148 at 471-517.

[156] "Reform and Harmonization", *supra* note 8 at 22 & 23.

[157] See "National and International Harmonization", *supra* note 148 at 481.

[158] See "Reform and Harmonization", *supra* note 8 at 26.

hypothec or pledge without dispossession) and the location of title to the collateral (e.g., sale with retention of title or sale subject to a rescission clause).

If a transaction is typified as commercial, it falls under the rules of the Commercial Code, the LGTOC, the LIC and the Bankruptcy Law, among other commercial laws. If it is typified as non-commercial (civil), then the secured transaction is governed exclusively by the Civil Code of any specific state or the Federal District.[159] For example, a pledge without dispossession or with constructive delivery is generally governed by the Civil Code and cannot be used to secure a commercial transaction, except for *habilitación o avío* or *refaccionario* credits. On the other hand, a commercial transaction may be secured by a movable hypothec, which is civil in nature.[160]

This kind of different treatment is also apparent in the field of installment sales secured financing arrangements, namely "conditional sales" (i.e., contract of sale subject to rescission, contract of sale with retention of title), which are very popular in Mexico.[161] By examining these security devices, we can conclude that in both cases the buyer takes possession of the goods and pays later, and the seller can repossess and sell the goods if the buyer defaults. If both transactions allow a secured creditor to exercise similar rights, for example, to repossess and resell the collateral in order to secure payment of what is due, would it not be better if both types of sales were treated alike? Why not take it a step further and incorporate conditional sales into movable hypothecs and pledges without dispossession?[162]

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[159] For more information on civil or commercial non-possessory security devices, see Part One, above.
[160] See R. Mantilla Molina, *Derecho Mercantil*, 21st ed. (México: Editorial Porrúa, 1981) at 71.
[161] See D.W. Warren, "Mexican Retail Installment Sales Law: A Comparative Study" (1962) 10 U.C.L.A. L. Rev. 15 at 16.
[162] See R. Rojina Villegas, *Derecho Civil Mexicano - Contratos*, 5th ed. (México: Editorial Porrúa, 1981) at 361-371; J.F. Bass, "Security Interests in Movable Property in Mexico" (1968) 4 Tex. Int'l L.F. 96 at 108;

Based on Article 9, the PPSAs and the CCQ, there are practical and legal-theoretical considerations that point to the advantages of making all security mechanisms subject to the same rules, which would accordingly be applied to all kinds of security interests.[163] Thus, the issue that arises is whether a basic and comprehensive notion of security interest would be compatible with the civil law conceptual framework. Professor Garro firmly believes it would be, stating that the fact that the province of Quebec adopted a broad notion of "hypothec"[164] and that the State of Louisiana adopted a verbatim replica of the concept of security interest as it appears in Article 9 reflects the compatibility, openness and willingness on part of civil law jurisdictions to adopt common law concepts with the aim of accepting a flexible notion of security interests adaptable to the needs of modern financing.[165]

He then provides, under his draft model rules on security interests for Latin America (Garro's Model Rules), a basic concept for security interest, which he names

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J.F. Munger, "Rights and Priorities of Secured Creditors of Personalty in Mexico" (1974) 16 Ariz. L. Rev. 767 at 771.

[163] See "Reform and Harmonization", *supra* note 8 at 28.

[164] In 1975, the Committee on the Law of Security on Property established by the Quebec Civil Code Revision Office recommended changes to the CCQ that, *inter alia*, would recognize a unified concept of "hypothec" in movable property. The recommendations were based on the recognition that any reform of the law on security on movables in Quebec must take into account both Article 9 of the UCC and the Canadian provinces' Personal Property Security Acts so that new rules established to govern real security on movable property might be consistent with the North American system and general business practice. See Civil Code Revision Office, 2.1 Report on the Quebec Civil Code, *Commentaries* (1978) at 425-504.

CCQ, *supra* note 141, art. 2660: "A hypothec is a real right on a movable or immovable property made liable for the performance of an obligation. It confers on the creditor the right to follow the property into whoever hands it may be, to take possession of it or to take it in payment, or to sell it or cause it to be sold and, in that case, to have a preference upon the proceeds of the sale ranking as determined in this Code."

CCQ, *ibid.*, art. 2687: "A hypothec may be granted to secure any obligation whatever." Moreover, hypothecs are divided into conventional and legal hypothecs (art. 2664). Conventional movable hypothecs are subdivided into (i) Movable hypothecs without delivery, where there is no delivery of the collateral to the creditor and which "on pain of absolute nullity shall be granted in writing" (art. 2696); (ii) Movable hypothecs with delivery, where "delivery of the property or title is granted to the creditor or, if the property is already in his hands, by his continuing to hold it, with the grantor's consent, to secure his claim" (art. 2702) and which "may also be called pledge (art. 2665); (iii) Movable hypothecs on a claim or on a universality of claims, which may be granted with or without delivery (art. 2710); and (iv) Movable hypothecs on ships, cargo or freight (art. 2714).

"right of security" *(garantía real)* and defines as "a right granted by an obligor to an obligee to be paid out of movable property in preference to other obligees". Additionally, he establishes that "a right of security is possessory if the collateral is delivered to the secured obligee or to a third person to hold it on behalf of the secured obligee; and a right of security is non-possessory if the obligor retains possession of the collateral".[166]

Furthermore, many of the gaps found in Mexican personal property security law are filled by applying the provisions of the Civil Code, which are meant to deal with contract and property law.[167] Consequently, some aspects of secured transactions are dealt by the general rules, which are applicable to all conventional obligations. For example, the pledgee's custodial obligations are governed by the provisions of the Civil Code concerning the contract of deposit.[168] Likewise, other issues are subject to the general principles of property law. For example, in all security interests title to the collateral is retained by the debtor while the creditor obtains a "real right" that is less than full ownership; thus, the debtor bears the risk of accidental loss or damage of the collateral.[169] It would be better if legislators were to treat the issues outside the traditional constraints imposed by law of property and contracts. They should enact a new set of comprehensive rules applicable only to secured transactions where the rights, obligations, remedies and enforcement procedures of the parties, as well as those held by third parties, are determined by the specific nature of each type of credit transaction, regardless of who, the debtor or the creditor, is the owner of the collateral.[170]

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[165] See "Reform and Harmonization", *supra* note 8 at 29.
[166] *Ibid.* at 126 (art. 3) & 129 (art. 16).
[167] See *ibid.* at 29.
[168] See *CCDF*, *supra* note 16, art. 2876.
[169] See *ibid.*, arts. 2873-2875.
[170] See "Reform and Harmonization", *supra* note 8 at 30.

III. Party Autonomy in the Creation of Security Interests

The role of party autonomy in the creation of non-possessory security interests is remarkably reduced in Mexico. This restrictive approach may be deduced from some of the principles used to treat personal property security law through the civil codes and applicable commercial laws. As was pointed out in Part One of this study, under the Mexican legal framework, "secured financing is available only where the affairs of the parties and the nature of the collateral are such that they may take advantage of a special regime of non-possessory security."[171] Now, it is believed that such a restrictive approach must be re-examined in light of the goals that personal property security law is supposed to pursue. Therefore, the issue here is whether security should be more accessible for borrowers and lenders than what is presently allowed in Mexico.[172]

This restrictive approach is specially illustrated in the creation of consensual[173] non-possessory security interests. Such restriction hinders the primary goal to be achieved through the law of secured transactions, namely, economic growth through facilitating the availability and use of secured credit financing. Furthermore, this restriction is entirely contrary to businesses' economic interest of obtaining credit. If non-possessory security interests are encouraged, then credit will become more available and consequently cheaper than under the current regime. However, encouragement of secured financing on a consensual basis shall not exclude reasonable legislative control.[174]

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[171] *Ibid.* at 31.
[172] See *ibid.*
[173] Qualification applied to a contract where for its perfection there is nothing else required additionally to the consent of the contracting parties. See R. De Pina & R. De Pina Vara, *Diccionario de Derecho*, 18th ed. (México: Editorial Porrúa, 1992) *s.v.* "*consensual*".
[174] See "Reform and Harmonization", *supra* note 8 at 31.

Unlike Mexican personal property security law,[175] under Article 9 practically any natural or legal person[176] may take a non-possessory security interest in any kind of personal property in order to secure the payment of his obligations. Here there are no restrictions whatsoever as to what classes of creditors may take security nor under what conditions.[177]

On the other hand, there are some Canadian legal scholars who justify using the restrictive approach. They argue that such party autonomy proselytizers have not proven that debtors and creditors acting in their own self-interest through contract are able to produce a more efficient distribution of society's economic resources than legislatures acting by way of statutorily imposed execution preference. Therefore, the choices as to (i) who should be entitled to take security, (ii) the scope and coverage of the security available, (iii) the underlying theory for establishing priorities, and (iv) the attribution of possessory and property rights as between debtor and creditor should be a matter of explicit legislative decision.[178]

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[175] For example, as was previously explained, *habilitación o avío* and *refaccionario* credits are said to be limited in scope and application because they are especially designed to be used by production enterprises (i.e., inventory financing will never be possible since nothing is produced). Another example under Mexican law would be the banking pledge and the industrial hypothec which their use is reserved exclusively for Mexican banking institutions. Therefore, this requirement would prohibit sale creditors, asset-based lenders, equipment and inventory wholesalers, and other possible lenders from utilizing these two specialized mechanisms.

[176] Under Article 9, any type of legal entity may become a secured party for any kind of non-possessory interest. Under Article 9 a "secured party" must be a person, but the term "person" includes any individual or organization, and the term "organization" includes "a corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two or more persons having a joint or common interest, or any other legal or commercial entity." *UCC*, *supra* note 6, ss. 1-201(28),(30).

[177] See "Reform and Harmonization", *supra* note 8 at 32.

[178] See R.A. Macdonald, "Modernization Of Personal Property Security Law: A Quebec Perspective" (1985) 10 C.B.L.J. 182 at 183 & 196. Additionally, he states: "Those who argue for other assumptions, including the position that the law should facilitate all types of secured lending, should at least have the burden of making these assumptions explicit so that genuine debate my be engaged. It is not sufficient to dismiss the regime of the civil law simply on the basis that it is not modern." Macdonald, *ibid.* at 195.

See also R.A. Macdonald, "Exploiting the Pledge as a Security Device" (1984) 15 Revue de droit (Université De Sherbrooke) 551 at 554-555 [hereinafter "Exploiting the Pledge"] (pointing to the absence of empirical research into the nature and effects of security on personal property and arguing that the goal

The issue that arises from this debate is whether the mentioned party autonomy in the creation of security interests should be encouraged in Mexico, following the model of Article 9.

Experience taken from Canada's common law provinces suggests that secured financing is desirable for economic growth and therefore should be facilitated by designing a coherent, comprehensive legislation where party autonomy is encouraged in the creation of security interests.[179] It has even been said by some legal scholars that debtors and creditors acting in their own self-interest through consensual security devices are able to produce a more efficient distribution of society's economic resources in comparison with legislation acting by way of statutory liens.[180] However, as was previously explained, there are others that disagree and state that secured financing should be left to the legislature.[181]

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of modernizing regimes of personal property security law need not be pursued exclusively on the model of Article 9). Professor Roderick A. Macdonald was Dean of McGill University's Faculty of Law and now teaches the subject of secured transactions. He extensively contributed on the reform in secured financing under the 1994 Quebec Civil Code. Currently, he is President of the Law Commission of Canada.

[179] See "Reform and Harmonization", *supra* note 8 at 33.

[180] See Ziegel & Cuming, *supra* note 144 at 249 *et seq.*

As stated by Professors Jackson and Kronman:

> If the law denied debtors the power to prefer some creditors over others through a system of security agreements, a similar network of priority relationships could be expected to emerge by consensual arrangement between creditors. Permitting debtors to encumber their assets achieves the same result, but in a simpler and more economic fashion. If a debtor has more than two or three creditors, free-rider and holdout difficulties are likely to plague any attempt on the part of the creditors to work out a set of priority relationships among themselves. These transaction costs can be avoided by allowing the debtor himself to prefer one creditor over another. The rule permitting debtors to encumber their assets by private agreement is therefore justifiable as a cost-saving device that makes it easier and cheaper for the debtor's creditors to do what they would do in any case.

T.H Jackson & A.T. Kronman, "Secured Financing and Priorities Among Creditors" (1979) 88 Yale L.J. 1143 at 1157.

[181] See Macdonald, *supra* note 178 at 183.

Regarding Quebec's system and justifying the restrictive approach, another legal commentator argues:

> Most creditors understandably share one weakness, and that is the desire to be secured against the failure or incapacity of their debtor to pay what he owes them at due date. It is the task of the law, not merely in the interest of equity and justice, but of commerce itself, to determine which creditors shall enjoy this favour and under what conditions. The free flow of commerce requires not only that certain persons or institutions be encouraged to extend credit by the guarantee which they are able to obtain of being paid, but that the ordinary unsecured creditor should not be driven from the field by the unreasonable extent to which others have by law or contract been given a preference over him. Among the considerations which must influence the legislator are the types of credit to be encouraged, the protection to be given to the creditor, the debtor and third persons, and the practical necessities of daily life and trade which will determine the kind of collateral offered and the appropriate security device for giving it.[182]

Professor Garro, on the other hand, feels that the reason why a legal system makes it harder rather than easier for parties to create non-possessory security interests does not stem from any conscious economic analysis. The restrictive approach taken by the French-inspired legislative framework was adopted as a result of the technical and practical difficulties associated with the publicizing the transfer and encumbrance of movable property, rather than as a consequence of careful and consistent policy criteria. Moreover, the restrictive approach determining which classes of creditors shall be allowed to take a certain type of security and over which kinds of personal property is very different from the approach taken under the law of pledge, demonstrating that the underdevelopment of non-possessory security is the result of a traditional distrust based on outmoded policy concerns instead of the convenience of acting by way of statutorily rationalized and correlated priorities. It is reasonable to expect that by increasing the sophistication of the current registry system for movable property, the role of party

autonomy in the creation of consensual non-possessory security is likely to be encouraged.[183]

However, some criticisms have developed regarding the encouragement of the availability of secured credit: (i) The negative effects that it might have on unsecured creditors who allege that their chances for obtaining satisfaction from the debtor's assets may be jeopardized as a result of the priority rights conferred on secured creditors. The primary objection of unsecured creditors is that personal property security legislation is unfair to them because it generally tips the balance heavily in favor of secured creditors. (ii) Additionally, borrowers generally assume that they have little bargaining power and are likely to be forced to give most or all of their assets.[184]

Professor Garro states that although the second argument has some substance, the validity of the argument revolves around the type of debtor and the competitiveness of the credit market involved. However, according to him, this argument is basically false because commercial debtors-borrowers with significant assets might have some bargaining power, especially if many sources of credit are available. Therefore, by removing restrictions on the availability of non-possessory security interests, debtors might obtain more favorable conditions of credit and consequently have more bargaining power. Moreover, in case a debtor defaults, exempting certain property from seizure may be a more effective solution to avoid leaving him without any property than limiting the availability of security interests.[185]

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[182] G.E. LeDain, "Security Upon Moveable Property in Quebec" (1956) 2 McGill L.J. 77.
[183] See "Reform and Harmonization", *supra* note 8 at 34 & 35. See also Drobnig, *infra* note 498 at 179.
[184] See "Reform and Harmonization", *ibid.* at 35, 176-177.
See also Ziegel & Cuming, *supra* note 144 at 271-277.
[185] See "Reform and Harmonization", *ibid.* at 36.

Furthermore, concerning the first argument and bearing in mind that although unsecured creditors are without a doubt prejudiced when their debtor grants security over his assets to secured creditors, Professor Garro states that it is untrue that secured credit economically operates unfairly against unsecured creditors, favoring the secured ones. However, he states that this supposedly unfair non-possessory security preference over unsecured creditors may be avoided by granting potential creditors the possibility to acquire knowledge of prior existing security interests. Thus, an unsecured creditor will have no one but himself to blame for choosing to extend credit on the basis of previous satisfactory dealings or good references.[186]

In addition, it has been said by other legal commentators in favor of less restrictive secured lending that secured creditors tend to charge lower interest rates because they rely on specific assets of a debtor rather than on the debtor's honesty and general financial health.[187]

Assuming all these arguments contain some element of truth, then the idea of encouraging secured credit rather than restricting it should be given careful consideration.[188] In conclusion, economic growth has always been one of the primary goals in any country, and Mexico is no exception. Credit helps to realize this goal. Therefore, a policy providing for an increase in the availability of credit is likely to foster economic growth. Personal property security law should thus promote the use of credit

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[186] See *ibid.* See also Ziegel & Cuming, *supra* note 144. See generally R.M. Goode, "Is the Law Too Favourable to Secured Creditors?" (1983-84) 8 C.B.L.J. 53 at 57 [hereinafter "Is the Law Too Favourable"] ("If an unsecured creditor is to be allowed to benefit from his speed and diligence in being the first to issue execution, should not his competitor be permitted to arm himself with security?").

[187] See D.G. Baird & T.H. Jackson, "Possession and Ownership: An Examination of the Scope of Article 9" (1983) 35 Stan. L. Rev. 175 at 183. But see Macdonald "Exploiting the Pledge", *supra* note 178 at 561 (noting that there is currently no data demonstrating that the availability of secured credit actually results in significant reductions to most borrowers' interest costs).

to achieve such growth. In conformity with these premises and although it cannot be proved that the availability and relative efficacy of non-possessory security has a measurable impact on the cost of commercial credit, it can at least be concluded that a legal system where secured credit is encouraged and made more accessible is more likely to foster and increase economic growth in a certain country than one that restricts secured credit in any way.[189]

IV. Property Subject to Non-Possessory Security Interests

As was stated above in Section B, one way in which Mexican law restricts the availability of non-possessory security interests, except for secured transactions in the form of pledge and sales with reservation of title,[190] is by enumerating the types of items that may be used as collateral for a specific transaction. This limitation exists by expressly enumerating and including in a statutory list the types of collateral that may be subject to the specific non-possessory security device, thereby excluding all other types of personal property not included in such list.[191] Take, for example, *habilitación o avío* and *refaccionario* loans.[192]

The actual Mexican regime, where restrictions on the collateralization of personal property as well as the establishment of separate forms of non-possessory security interests for different types of collateral exist, should be abandoned. Instead, any person should be permitted to create a security interest over virtually every kind of movable property, whether corporeal or incorporeal, owned by the debtor or yet to be acquired by him, specific or in a state of constant change.[193]

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[188] See R.M. Goode, "The Modernization of Personal Property Security Law" (1984) 100 L.Q. Rev. 234 [hereinafter "Modernization of PPSL"].
[189] See "Reform and Harmonization", *supra* note 8 at 37.
[190] In Mexico, all kinds of personal property (movables) that can be sold may be used as collateral in a pledge and a sale with reservation of title. See *CCDF*, *supra* note 16, arts. 2856, 2312 & 747-749.
[191] See "Reform and Harmonization", *supra* note 8 at 37 & 38.
[192] See Part One, above, regarding *habilitación o avío* and *refaccionario* credits.
[193] *CCQ*, *supra* note 141, art. 2666: "A hypothec is a charge on one or several specific corporeal or incorporeal properties, or on all the properties included in a universality." *CCQ*, *ibid.*, art. 2668: "Property

Following Article 9, Mexican law should differentiate types of collateral according to the specific problems posed by each secured transaction and the use intended by the debtor. Additionally, a comprehensive set of definitions for each type of movable should be formulated. The end result would be a set of rules for the dissimilar elements of secured transactions and at the same time a set of rules covering their common aspects.[194]

A. EXPANDING THE COLLATERALIZATION OF PERSONAL PROPERTY

Restricting the property subject to non-possessory security interests is an approach believed to be the result of a prolonged uncoordinated legislative process. It is evident that the gradual acceptance and regulation of the particular types of non-possessory security interests over particular kinds of collateral correspond to the specific sectors of the economy in which the demand for credit intensified at specific points in time.[195] Although such a trend is believed not to respond to a rational approach, we should be mindful of the specific instances in which such restrictions were brought in response to the underlying policies of the personal property security law serving the country in question, in this case Mexico. Moreover, this study shall also consider alternative ways to recognize the same policy goals of Mexico. However, this does not necessarily suggest we should cease efforts to make the collateralization of personal property less restrictive.[196]

In conclusion, an approach that fosters the expansion of the collateralization of personal property shall presumably make secured creditors feel better protected and

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exempt from seizure may not be hypothecated. The same rule applies to movable property belonging to a debtor which furnishes his main residence and which is used by and is necessary for the life of the household."

[194] See "Reform and Harmonization", *supra* note 8 at 38.

[195] For examples of these, see *habilitación o avío*, *refaccionario*, and banking pledge in Part One, above.

[196] See "Reform and Harmonization", *supra* note 8 at 38.

therefore more willing to offer credit on better terms. This proposal shall surely help the financing of small businesses.[197]

B. DISTINCTIONS AMONG DIFFERENT TYPES OF COLLATERAL

The conceptual approach towards movable property provided by the Mexican Civil Code and the various applicable commercial laws is of no help in distinguishing among different types of secured transactions in light of the different natures of the items given as collateral. For example, the Civil Code in its Article 753 broadly defines the concept of movables: "Movables by nature are those items that may be carried from one place to another, whether moving by themselves or by an external force."[198] This broad definition applies to all types of legal transactions in general and is not designed to deal specifically with problems arising in the context of secured transactions. The Civil Code also distinguishes between rules applicable to the transfer of ownership in corporeal (things) and incorporeal (rights) movables,[199] but fails to provide solutions for specific problems arising from the creation and perfection of security interests in that kind of collateral regarding those types of property. As a result, these broad concepts should be abandoned for the purposes of secured transactions and a new set of rules should be designed to distinguish between consumer, agricultural, and commercial credit transactions for security interests. Therefore, while retaining the idea of achieving a generic concept of "security interest" or "hypothec" with uniformity of regulation and effect, the proposed new set of rules should also include a variety of classifications responsive to the specific problems posed by the nature of the different kinds of property

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[197] See *ibid.* at 39.

[198] On the other hand, focusing on the mobility of the object, immovables are those that cannot move or be moved from one place to another, this steadfastness or immobility being its principal feature. See *CCDF*, *supra* note 16, art. 750.

given as security. There are different approaches that may be created and adopted according to the treatment or use of said property, for example, depending on whether the collateral is definitely located (e.g., industrial equipment) or highly mobile (e.g., motor vehicles); whether it is susceptible to specific identification (e.g., machines or domestic appliances held for resale), or a fungible mass not subject to such identification (e.g., canned foodstuffs), or a shifting, changing conglomeration not easily describable (e.g., inventory involved in a manufacturing process).[200]

Moreover, the Mexican legal system, by distinguishing between civil and commercial transactions based on the personal status of the parties (merchant or non-merchant), has proved to be very confusing, especially for those transactions where each party has a different status. Probably, a simpler, more comprehensive criterion for dealing with the peculiarities presented by each different credit transaction could be achieved by adopting a scheme similar to that of Article 9, where secured transactions are categorized according to the intended use given by the debtor to the property disposed as collateral (e.g., consumer, farmer, merchant, etc.), rather than its corporeal or incorporeal nature.[201]

> Under Article 9,[202] personal property for the purposes of secured transactions is divided into consumer goods,[203] farm products,[204] and personal property used in business enterprises, which is subdivided into

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[199] See *ibid.*, arts. 752 & 754.
[200] See "Reform and Harmonization", *supra* note 8 at 40.
[201] See *ibid.* at 41 & 42.
[202] See *ibid.* at 41; *UCC*, *supra* note 6, s. 9-109. See generally L.Y. Smith & G.G. Roberson, *Business Law*, 4th ed. (St. Paul, Minn.: West Publishing Co., 1977) at 906-907.
[203] See *UCC*, *ibid.*, s. 9-109(1). Goods are "consumer goods" if they are used or bought for use primarily for personal, family or household purposes (e.g., washing machine and clothe dryer). The main reason for having this separate category of collateral is to exclude it from the filing system.
[204] *Ibid.*, s. 9-109(3) ("crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their un-manufactured states (i.e., ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations ...."). "Farm products" must be held by a debtor engaged in farming operations in order to be recognized as such.

> property intended for use in the business (equipment)[205] or for sale (inventory)[206] or represents the proceeds of the sale of inventory (accounts, general intangibles).[207]

Equally useful are Garro's Model Rules, where he provides that the collateral subject to a right of security may be corporeal movables, documentary collateral, or incorporeal movables. Corporeal movables included: "consumer goods" *(bienes para consumo personal)*; "equipment" *(equipos)*; "farm products" *(productos agrícolas)*; and "inventory" *(existencias comerciales y materias primas en general)*. Under documentary collateral *(documentos en garantía)*, he includes: "document of title" *(documento representativo de mercaderías)*; "instrument" *(título de crédito)*; and "chattel paper" *(título prendario)*. Under incorporeal movables, he includes "account" *(cuenta por cobrar)*.[208]

C. Regulation of Wholesale Financing Arrangements

Experience has shown that the most important source of credit for small businesses in Latin America is the trade credit they get from their suppliers and finance companies. For instance, a supplier may finance a dealer on the basis of the latter's inventory, and the dealer may get further financing from his supplier or from independent

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[205] See *ibid.*, s. 9-109(2). Goods are classified as "equipment" if they are used or purchased for use primarily in business (including farming or a profession), and if they are not included in the definition of inventory, farm products, or consumer goods. This category is broad enough to include a lawyer's library, a physician's office furniture, or machinery in a factory.

Under the premise that an item of goods may fall into different classifications depending on its use or purpose, the following example may give a clear illustration of what is meant by this proposed approach: a refrigerator purchased by a physician to store medicines in his office is classified as *equipment*, while the same refrigerator would classify as *consumer good* if purchased for use in his home, or even classify as *inventory* in the hands of a refrigerator dealer or manufacturer.

[206] See *ibid.*, s. 9-109(4). The term "inventory" includes goods held for sale or lease, as well as raw materials, work in process, or materials used or consumed in a business. Thus, a retailer's or wholesaler's merchandise as well as a manufacturer's materials are inventory.

[207] See *ibid.*, s. 9-106. Although both "equipment" and "inventory" are primarily used in commercial financing, separate rules apply to both types of collateral. On the one hand, if the collateral is equipment the secured creditor has no reason to suppose that the collateral will be resold and can legitimately expect to assert his security interest over the claims of third parties. On the other hand, inventory in constantly changing and being turned over and replaced, and the secured creditor needs to be able to extend his security interest to proceeds (i.e., accounts receivable, cash, checks or chattel paper). See *ibid.*, ss. 9-306 & 9-312(3).

[208] "Reform and Harmonization", *supra* note 8 at 128 (art. 12).

finance companies by assigning his accounts receivable. However, these two financing methods (inventory and accounts receivable financing) do not fulfill their desirable purpose and consequently are not satisfactory transactions in Mexico, where in addition there is a wholly inappropriate legal structure for their development. Therefore, a set of rules similar to the guidelines provided by Article 9 should be designed for these financial arrangements at the manufacturer-dealer level. To realize this goal, a consensus regarding the extent to which present or future assets can be available as security for obligations arising in the future and how can accounts receivable be used effectively as collateral must be reached.[209]

1. Inventory Financing

Inventory is the stock in trade of a retailer. It is also the materials required by a manufacturer in the course of his daily production. Inventory changes constantly, being turned over and replaced. An inventory financier is necessarily interested in the use and disposition of the proceeds from the sale of inventory in which he has a security interest, which may be in the form of cash, checks, accounts, chattel paper (probably installment or conditional sale contracts), or traded-in goods.[210] Inventory financing is an important form of security often sought to meet the needs of debtor companies in the dealing of its circulating assets in their ordinary course of business.[211] In the field of inventory financing, experience in the United States under Article 9 shows that it is extremely useful to allow appropriate contractual agreements by which the security interest is

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[209] See *ibid.* at 42.

[210] See Smith & Roberson, *supra* note 202 at 907.

[211] *CCQ*, *supra* note 141, art. 2684:

> Only a person or a trustee carrying on an enterprise may grant a hypothec on a universality of property, movable or immovable, present or future, corporeal and incorporeal. The person or trustee may thus hypothecate ... claims and customers accounts ... corporeal movables included in the assets of any of his enterprises kept for sale, lease or processing in the manufacture or transformation of property intended for sale, ...

extended to property other than the original collateral and also to amplify the secured obligation to future claims of the creditor.[212]

After a careful survey in this field,[213] it is not possible to formulate in Mexico a scheme similar to that of Article 9 without addressing the effects of after-acquired property clauses[214] and the giving of security for future advances.[215]

The Mexican legal system has shown some objections towards after-acquired property clauses. The first one, based on formalistic grounds, involves the difficulties in describing the collateral covered by the security agreement and additionally identifying the incoming goods subject to the security interest. The second objection is based on public policy concerns, which include the monopoly that an after-acquired property clause gives to the first creditor-financier. This is seen as a negative effect from the viewpoint of the debtor and unsecured creditors because such clause gives enormous power to a single lender while strongly restricting the debtor's freedom of action.[216]

However, several solutions have been formulated in response to these objections. For example, the first objection could be solved if the collateral were identified as a whole rather than by its component parts; the problem of identification of the collateral could be attacked and solved at the conceptual level. Therefore, inventory should be viewed as a unit where the precise identification of its components should not be necessary as long as the inventory is capable of being identified in general terms.[217] Moreover, the problem of tracing or identifying incoming goods subject to the security

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[212] "Many civil law countries fail to recognize "floating charges" of any sort, but in those jurisdictions where they have been accepted, inventory financing has become a fundamental part of the financial structure of commercial and industrial credit." "Reform and Harmonization", *supra* note 8 at 42.

[213] *Ibid.* at 43.

[214] "A clause in a security agreement providing that any property acquired by the borrower after the date of the loan and security agreement will automatically become additional security for the loan." Black, *supra* note 15, *s.v.* "after-acquired property clause".

[215] Money lent after a security interest has attached and secured by the original security agreement (*UCC*, *supra* note 6, ss. 9-204(5)). *Ibid.*, *s.v.* "future advances".

[216] See "Reform and Harmonization", *supra* note 8 at 43.

[217] *CCQ*, *supra* note 141, art. 2697 confronts this formalistic issue: "A sufficient description of the hypothecated property shall be contained in the act constituting a movable hypothec or, in the case of a universality of movables, an indication of the nature of that universality."

interest could be solved if, instead of continuing with the traditional idea where the new goods are considered to be replacements of or substitutes for the collateral that has been disposed, an after-acquired property clause were included in the security agreement, where its scope would extend to all property thereafter acquired by the debtor.[218]

The second objection has proven to be more difficult to address; yet such reluctance to give so much power to a single lender is understandable. It is certainly true that if a security interest in collateral consisting of after-acquired property is permitted to rank as of the date of filing, eminently favoring the secured creditor, then any further potential creditors contemplating a loan to the borrower will probably not be willing to take a second lien because of the enormous uncertainty that such a clause and respective ranking of the secured creditor will leave as to the collateralized property. This is understandable from the potential lender's viewpoint, since he will want to be certain of the borrower's actual and future assets covering previously entered security arrangements. Additionally, he will also want to know his ranking position against these previous financiers.[219]

Nevertheless, inventory financing cannot operate without giving effect to after-acquired property clauses, making further consideration of this problem inevitable. Instead of prohibiting floating charges,[220] it would be more useful to establish reasonable

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[218] "Reform and Harmonization", *supra* note 8 at 43. *CCQ*, *supra* note 141, art. 2674: "A hypothec on a universality of property subsists but extends to any property of the same nature which replaces property that has been alienated in the ordinary course of business of an enterprise. .... If no property replaces the alienated property, the hypothec subsists but extends only to the proceeds of the alienation, provided they may be identified."

[219] See "Reform and Harmonization", *ibid.*

[220] See Smith & Roberson, *supra* note 202 at 908.

> The term "floating charge" is descriptive of a security interest in changing collateral. While all collateral changes to some extent - an automobile deteriorates, a crop grows and is harvested - the above description applies particularly to collateral that is inventory, the proceeds from its sale, and the stock of fresh inventory acquired by way of replacement; and also to accounts receivable, the proceeds from their collection, and subsequently created accounts receivable generated by future sales. In the case of a merchant's inventory, the security interest in any specific item of inventory terminates upon its sale in the ordinary course of business, but attaches to the new inventory which replaces or replenishes the stock. The constant changes and turnover of inventory and receivables in the operation of a mercantile business may be likened to the flow of a

limitations to prevent the monopoly of the first lender under such clauses. These safeguards could be borrowed and designed in accordance with those provided by Article 9. First, the effects of an after-acquired property clause are drastically reduced in non-commercial secured transactions;[221] second, the debtor has the right to obtain, by demanding that the secured party send a termination statement, the cancellation of the effects of obsolete financing statements when there is no outstanding obligations and no commitment to make future advances;[222] and third, a security interest under an after-acquired property clause is outranked by a subsequent purchase-money security interest[223] on the basis that the latter contributes to the acquisition of a new non-monetary asset of the debtor's estate, thus permitting the borrower to obtain advances from creditors other than the original lender, who has given credit under an after-acquired property clause.[224] Professor Garro states that "given these safeguards, full recognition of after-acquired property clauses appears wholly beneficial to commercial financing".[225]

In addition, wholesale financing also calls for an adequate legal structure within which the parties may arrange a continuing line of secured credit. The provision of credit on an on-going or revolving basis is an essential characteristic of today's business financing, and as such, the Mexican legal system should pay special attention to it in order to avoid hindering inventory financing.

> stream or river. Although the specific water in the stream at any particular time and place changes from hour to hour, the stream remains the same. The Code permits a security interest to be perfected to a stream of changing collateral of this type by the inclusion of an "after-acquired property clause" in the security agreement and the financing statement. Section 9-306.

[221] *CCQ*, *supra* note 141, art. 2686: "Only a person or a trustee carrying on an enterprise may grant a floating hypothec on the property of the enterprise."

[222] See *UCC*, *supra* note 6, s. 9-404.

[223] A security interest is a "purchase-money security interest" to the extent that it is: (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person (i.e., third party or bank) who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used. See *ibid.*, s. 9-107.

[224] However, under Article 9, a prospective purchase money financier must comply with several requisites in order to be entitled to this right. See *ibid.*, s. 9-312.

[225] "Reform and Harmonization", *supra* note 8 at 44.

However, these obstacles can be solved by designing a set of rules similar to Article 9, where the position of secured creditors is strengthened. Under Article 9, future advances are treated as though they were made contemporaneously with the filing of the original financing statement. In other words, a security interest under a future-advance clause ranks as of the time of filing, thus expanding the parties' party autonomy in arranging their affairs in order to meet their needs and without making the secured creditor register a new financing statement each time new amounts are advanced to the debtor. Additionally, under Article 9, there is no need to take successive security agreements that list specifically each item of the collateral acquired by the dealer. The secured creditor is not required to register an agreement or memorandum in connection with every new advance; nevertheless, this is possible not only by the absence of a requirement to describe the collateral in detail but also by a "notice filing" system, which permits a secured creditor to meet the publicity requirement by filing a single statement giving notice that he is or may be lending against the security of assets of the general type described, whether presently owned by the debtor or acquired by him in the future.[226]

Another aspect of Mexican law is that a secured creditor is obliged to specify the total amount of credit that has been or will be extended to the debtor in the security agreement filed for registration.[227] Unlike Mexican law, Article 9 does not require the potential amount of the secured obligation to be stated in the security agreement or financing statement. This approach adopted by Article 9 is very surprising because, on the one hand, the absence of such a requirement provides comfort to the secured creditor, but on the other hand, other creditors are affected by the uncertainty of eventual advances. This affects the knowledge of a potential second lender as to the actual significance of a previous loan arrangement to the priority status of the advances to be eventually extended. Nevertheless, Article 9 is believed to resolve this problem by

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[226] See *ibid.* at 45 & 46.
[227] See *CCDF*, *supra* note 16, art. 3070(iii).

entitling the debtor to obtain a statement of termination, which the secured creditor is bound to provide if there is no outstanding obligation. Mexican legislators would be wise not to follow the latter approach under Article 9 and to demand that a maximum for future advances be established in the loan agreement, as required under the CCQ.[228] The advantage of the Quebec approach is that by specifying such maximum amount, a lender about to take a second security interest would be able to ascertain the extent to which a prior secured creditor whose financing statement has been previously filed will extend to new advances that will further outrank the second lender's security interest. On the other hand, this requirement will not affect negatively the first lender because he will be allowed to set a comfortable maximum amount that shall give him plenty of margin for any planned advances. Moreover, requiring registry officers to issue a termination statement after verifying with the secured party of record that there is no outstanding obligation would also be helpful.[229]

2. Accounts Receivable Financing

Accounts receivable,[230] in addition to inventory and equipment, is an important financing mechanism for manufacturers and merchants. Collateralization of accounts receivable, by which cash can be obtained, helps businesses without much capital to get started and facilitates the expansion of those already existing.[231]

The Mexican Civil Code and the various applicable commercial laws were designed for secured transactions affecting tangible collateral. Therefore, security interests in accounts receivable present two problems: (1) the intangibility of the

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[228] *CCQ*, *supra* note 141, art. 2689: "An act validly constituting a hypothec indicates the specific sum for which it is granted. The same rule applies even when the hypothec is constituted to secure the performance of an obligation of which the value cannot be determined or is uncertain."

[229] See "Reform and Harmonization", *supra* note 8 at 47.

[230] The UCC recognizes three kinds of collateral as neither goods nor "paper" collateral, namely, accounts, contracts' rights, and general intangibles. These types of intangible collateral are not evidenced by any indispensable paper. The term "account" or "accounts receivable" refers to the right to payment for goods sold or leased, or for services rendered, which is not evidenced by an instrument or chattel paper. See Smith & Roberson, *supra* note 202 at 909.

[231] See "Reform and Harmonization", *supra* note 8 at 47.

collateral; and (2) the involvement of someone (the accounts receivable debtor) other than the secured party and the debtor.[232]

The Mexican Civil Code does not prohibit a debtor from assigning future accounts or rights *(cesión de derechos)*[233] as they come into existence.[234] A workable system for making effective the successive assignments of receivables without the need to notify account-debtors must be devised.[235] Priority goes to the assignee who first notifies the account debtor.[236] Under this scheme of priorities, the assignment of accounts receivable is vulnerable to all sorts of attacks until the account debtor is notified or he acknowledges the assignment in writing before a judge or a notary public.[237] These requirements are the only available means for perfecting a transfer of accounts. In sum, this mechanism requires: (i) a retailer who needs credit for his business operations and who wants to use the amounts due by his customers as security for a loan; and (ii) that this retailer shall verify that the customers are informed of the assignment or that each individual customer acknowledges the assignment by a judicial or notarial document; otherwise, the customer may discharge himself by paying the retailer.[238]

For retailers and accounts financiers, these notification requirements are inconvenient. Retailers generally prefer to have a direct relation with their customers and thus continue collecting the accounts without customers' knowledge of the assignment. Moreover, regarding the accounts' financiers, these requirements are also most troublesome because unless the customers are notified of or consent to the assignment,

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[232] See *ibid.* at 48.
[233] *CCDF*, *supra* note 16, art. 2029: "There shall be an assignment of rights when the creditor transfers to another person whatever he has against his debtor."
[234] An assignment of rights *(cesión de derechos)* shall comprise all its accessory rights, like the surety, mortgage, pledge or privilege, except for those not separable from the assignor. See *ibid.*, art. 2032.
[235] See "Reform and Harmonization", *supra* note 8 at 47.
[236] See *CCDF*, *supra* note 16, art. 2039.
[237] See *ibid.*, arts. 2034 & 2036.
[238] See *ibid.*, arts. 2040 & 2041.

the lender will be exposed to the risk of being outranked by other creditors of the retailer or by subsequent assignees.[239]

Notification to the account-debtor, as required by Mexican law, is extremely impractical in modern financing because accounts receivable are a constantly changing form of property. Therefore, generally, while new accounts are created in a business, the existing ones are paid and so on. For instance, where a security agreement is entered into by the debtor to cover all existing accounts as well as those arising in the future and he shall be required to give as collateral future claims against his customers, it will not be possible to comply with the notification requirement, since it would not be clear at the time of the assignment what account-debtors had to be notified. As a result, it is not surprising to find that the business and financial practice of continuing the assignment of large numbers of accounts receivable is not part of the business practice in Latin America, where after-acquired accounts receivable cannot be automatically added to the security interest.[240]

Following this examination of accounts receivable financing, it is clear that Mexican legislators must devise another method for determining priority between two or more assignees of the same account. Experience with Article 9 has shown that there are unquestionable advantages if public registration is used because public registration is the most suitable machinery for perfecting security interests in accounts, replacing the rule that priority goes to the assignee who first notifies the account-debtor with a simple first-to-file priority rule.[241]

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[239] See "Reform and Harmonization", *supra* note 8 at 49.
[240] See *ibid.* at 50.
[241] See *ibid.* See also *UCC*, *supra* note 6, s. 9-302.

V. Content in Security Agreements

A. Formalities

In Mexico, formalities for non-possessory security interests are required in order to create and to enforce them against third persons. For example, non-possessory security interests will not be opposable against third parties unless they are evidenced in writing and properly registered in the Public Registry.[242] When Mexico's regime for secured transactions was designed, its legislators envisioned the following purposes: (i) to minimize opportunities for dispute concerning the creation of a security interest or the precise property collateralized; and (ii) to prevent fraud. The issues for discussion here is whether a written security agreement should be required, whether such agreement should contain essential particulars in order to be effective, and whether there should be a prescribed form.[243]

Previously in this study, it was suggested that parties entering into a consensual non-possessory secured transaction should be allowed ample freedom and informality, and that formal requirements should be exclusively reduced to the evidentiary problem of whether or not a security interest had been created by the parties.[244] Therefore, the approach proposed here for consideration and future adoption in Mexico is the scheme followed under Article 9 and the one followed under the CCQ, which is somewhat similar. On the one hand, under Article 9, formal requirements are reduced to a memorandum in writing that reasonably identifies the property or rights (collateral) subject to the security interest and which is signed by or on behalf of the debtor.[245] On

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[242] See *CCDF*, *supra* note 16, art. 2859 & 2860.
[243] See "Reform and Harmonization", *supra* note 8 at 50 & 51.
[244] See *ibid.*
[245] See *UCC*, *supra* note 6, s. 9-203.

the other hand, the CCQ provides: "A movable hypothec without delivery shall, on pain of absolute nullity, be granted in writing";[246] and "A sufficient description of the hypothecated property shall be contained in the act constituting a movable hypothec or, in the case of a universality of movables, an indication of the nature of that universality".[247]

Moreover, under Garro's Model Rules, he establishes the following with regards to the writing requirement in a contract of security:

> (i) a right of security may only arise by virtue of a valid contract of security that indicates the obligor's intention to create a right of security; (ii) a contract of security is not effective against the obligor and third parties unless it is in writing; (iii) a contract of security is in writing if it is contained in a document signed by the obligor or on his behalf; the signature of the obligor need not be notarized or otherwise authenticated, and it may be made by a stamp or mechanical means as well as by hand; and (iv) if the secured obligee has taken possession of the collateral the contract of security need not be in writing for its validity between the parties.[248]

Additionally, notwithstanding that in some instances the formalities required might prevent fraud, many other security interests that have no fraudulent motive also run the risk of being defeated due to minor non-compliance with the formal requirements required by law. To prevent such misfortune, a written document should be signed by or on behalf of the debtor, whereby he expressly or implicitly indicates that the purpose of the transaction is to create a security interest, and provides a sufficient description of the collateral. This formality would offer enough evidence as to the creation of a security interest and the precise property affected, while at the same time making the taking of security easier and cheaper. In a commercial setting not involving consumers, a formal approach to the creation of non-possessory security interests is not justified.[249]

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[246] *CCQ*, *supra* note 141, art. 2696.
[247] *Ibid.*, art. 2697.
[248] "Reform and Harmonization", *supra* note 8 at 129 (art. 17).
[249] See *ibid.* at 51.

B. MINIMUM CONTENT

Another requirement in need of reassessment is the amount of detail to be included in the written security agreement. The detailed format required by law includes, among other things, the identification of the parties, a description of the nature and amount of the secured obligation, a description of the collateral, the date of execution of the agreement, and the signature of the registry officer.[250] What is argued here is that, although all these details are important and it would be wise to include them in a carefully drafted security agreement, it is not useful to impose them as a legal requirement. The reason for this is that sometimes injustice might result if, for example, a security agreement, otherwise valid, were rendered unenforceable by the courts for what might well be a technical omission. In other words, even though some of the mentioned information required by law is omitted from a security agreement, there are some cases where there is no doubt about that information not appearing in the document. Therefore, in such cases the agreement should be considered as enforceable by the courts.[251]

Unlike Mexican law, neither Article 9 nor the CCQ contain detailed provisions as to the contents of a security agreement. All that Article 9 and the CCQ require is that the agreement provide for the creation of a security interest and contain a description of the collateral, which does not need to be specifically provided if it is reasonably identified.[252]

Canadian legislation also merely requires a description of the property "sufficient to enable it to be identified",[253] or a description "which enables the type or kind of collateral taken under the security agreement to be distinguished from types or kinds of collateral which are not collateral under the security agreement".[254]

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[250] See *CCDF*, *supra* note 16, art. 3070.
[251] See "Reform and Harmonization", *supra* note 8 at 52.
[252] See *ibid.*
[253] *UPPSA*, *supra* note 149, ss. 9(1).
[254] *Saskatchewan Personal Property Security Act* (SPPSA), ss. 10(1)(b).
The Saskatchewan Law Reform Commission published a report in 1971 proposing a Personal Property Security Act for Saskatchewan based in part on the Uniform Act, but

Under Garro's Model Rules, he specifies that "a contract of security shall indicate the intention to create a right of security and shall: (i) reasonably identify the collateral; (ii) state the amount or the maximum amount of the secured obligation; and (iii) indicate the date of execution of the contract."[255]

In conclusion, Mexico should allow any form of agreement that states the granting or retention of a security agreement and identifies the property given as collateral in a reasonable way. Parties should be given flexibility in deciding the amount of detail to be included in their security agreement according to their specific needs and circumstances. Lastly, a mandatory standard form required for a security agreement should be avoided; nevertheless, it might be advisable to suggest the use of a form containing the minimum details such agreement should include, but only for convenience, without making such format legally compulsory.[256]

VI. Default Procedures

Because a credit-oriented scheme of remedies is of importance for modern commercial financing, Mexico should shift to an approach where the liberalization of default procedures (enforcement of security interests upon the debtor's default) is gradually increased, specifically in a commercial context. This liberalization would give secured creditors more freedom to exercise their remedies, irrespective of the location of title to the collateral. It is believed that among such remedies the following should be included: (i) the right of the parties to agree on forfeiture clauses; (ii) the right of the

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containing a number of significant new features. The Saskatchewan Legislature responded by enacting a PPSA in 1980. Personal Property Security Act, S.S., ch. P-6.2 (1993) (Can.). For a detailed analysis of this Act, see R.C.C. Cuming & R.J. Wood, Saskatchewan And Manitoba Personal Property Security Acts Handbook (1994).

See "Article 9 North of 49°", *supra* note 141 at 975.

[255] "Reform and Harmonization", *supra* note 8 at 129 (art. 18).

[256] See *ibid.* at 53.

creditor to take possession of the collateral after default with the consent of the debtor; (iii) the right of the creditor to pursue the debtor for any deficiency remaining after realization of the security (except, for example, where this had arisen from the secured creditor's failure to act in a commercially reasonable manner); and (iv) the right of the parties to private foreclosure.[257]

The Mexican Civil Code expressly provides that a stipulation by which title to the collateral is transferred to the secured creditor upon the debtor's default *(pacto comisorio)* is null and void,[258] even though the collateral is of less value than the debt.[259] However, both the Civil Code and the LGTOC validate forfeiture clauses only if concluded after maturity of the secured obligation (*Ex post facto* Giving in Payment). Here the creditor may keep the collateral at a fixed price; nevertheless, this shall not damage the rights of third parties.[260] In Mexico, a creditor must request that the court authorize sale of the collateral and collect its proceeds.[261] The LGTOC provides secured creditors with a streamlined executory process action *(juicio ejecutivo)* in order to speed up the foreclosure, giving the debtor the opportunity to raise any objections and limiting the time within which those objections may be raised.[262]

Unlike Mexican law, which provides for the intervention of a public authority (i.e., a judge) for the sale of the collateral *(venta judicial)*,[263] Article 9 gives the secured

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[257] See *ibid.*

[258] "... of no validity or effect. .... "Null and Void" means that which binds no one or is incapable of giving rise to any rights or obligations under any circumstances, or that which is of no effect." Black, *supra* note 15 *s.v.* "Null and void".

[259] See *CCDF*, *supra* note 16, art. 2887. Additionally, a clause that prohibits the creditor to apply to the court for sale of the collateral is also null and void. The reason seems to be obvious, the finality of the pledge eventually consists of the sale of the collateral in case the debtor does not comply with his obligation. See Treviño García, *supra* note 13 at 707.

[260] See *ibid.*, art. 2883; *LGTOC*, *supra* note 33, art. 344. Moreover, the debtor has the right to request the suspension of the sale of the collateral and shall pay the debt within 24 hours after being given such suspension by the judge. See *CCDF*, *ibid.*, art. 2885.

[261] See *CCDF*, *ibid.*, art. 2881.

[262] See *LGTOC*, *supra* note 33, art. 341.

[263] If the debtor does not pay in the term he had agreed, or when he is obliged to pay according to Article 2080 of the Civil Code, the creditor may request the sale of the collateral by public auction under the

creditor the power to seize and sell the collateral without judicial approval. Article 9 permits the creditor to: (i) declare when the debtor is in default;[264] (ii) repossess the collateral if this can be done without "breach of the peace";[265] and (iii) sell the property at a public or private sale.[266] All these rights of the secured creditor are granted to him without any order or writ issuance from a court. Contrary to the requirements imposed under Mexican law, Article 9 does not prohibit forfeiture clauses, even if entered into before the debtor defaults. Additionally, the secured creditor may propose to the debtor, by sending a written notice to him,[267] that he is willing to retain the collateral to satisfy the debt; but if the debtor rejects such proposal, then the secured creditor must dispose of the collateral in a "commercially reasonable manner".[268]

Article 9 suggests that secured creditors should be granted more freedom in exercising their remedies. Therefore, it is believed that there are three main areas in Mexican personal property security law where reform is needed: restrictions on (1) the use of forfeiture clauses, (2) self-help repossession, and (3) the private sale of the collateral.[269]

Regarding the first restriction, forfeiture clauses should not be extended to agreements that the parties may reach after the debtor has defaulted.[270]

Concerning the second restriction, unlike in the common law, the self-help remedy has been firmly prohibited in the civil law tradition;[271] nevertheless, the Mexican

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judge's instructions, but not without previously having notified the debtor or whoever granted the pledge. See *CCDF*, *supra* note 16, art. 2881.

[264] See *UCC*, *supra* note 6, s. 1-208.

[265] See *ibid.*, s. 9-503.

[266] See *ibid.*, s. 9-504.

[267] In case of non-consumer goods, the proposal must be previously sent to any other secured party from whom written notice was received of a claim or an interest in the collateral. See *ibid.*, s. 9-505(2).

[268] *Ibid.*

[269] See "Reform and Harmonization", *supra* note 8 at 55 & 56.

civil legal system should accept and permit self-help repossession as a remedy, but only with the debtor's consent. However, when the debtor resists, special and speedy sequestration proceedings should be available and enforced.[272]

Keeping in mind that one of the main goals of default proceedings is to promote disposition of the collateral at the highest possible price, disposition of the collateral by way of a private sale, in addition to the already existent public foreclosure sales, should also be permitted and recognized as the rule, not the exception.[273] The only restriction should be that such sale must be made in a "commercially reasonable manner",[274] as suggested by Article 9. This remedy will eliminate the costs involved in courts' foreclosure procedures. This would imply that public sales should be limited to those instances where the parties fail to agree on a price and method for the disposition of the collateral.[275]

In addition to Article 9, the CCQ strongly supports these proposals. For example, under the CCQ,[276] in addition to the applicable provisions provided in the Code of Civil Procedure of Quebec, creditors may have the following rights when a debtor defaults: (i)

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[270] See *ibid.* at 55.

[271] Since Colonial law, there has been a fundamental principle that prohibits anybody to take the law into one's own hands. It is believed, that judges are appointed for that reason in order to provide men with justice with their decisions. See *ibid.*

[272] See *ibid.* at 56.

[273] Article 2884 of the CCDF provides that the parties may agree on an "extra-judicial sale" but does not provide any further details.

[274] Professor Garro defines a sale in a "commercially reasonable manner" as:

> (i) the fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured obligee is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner; (ii) if a secured obligee either sells the collateral in the usual manner in any recognized market therefor, or if he sells at the price current in such market at the time of this sale, or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold, he has sold in a commercially reasonable manner.
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> See "Reform and Harmonization", *supra* note 8 at 145 (art. 88).

[275] See *ibid.* at 56.

[276] See *CCQ*, *supra* note 141, art. 2748.

they may take possession of the charged property to administer it,[277] (ii) take it as payment of their claim,[278] (iii) have it sold by judicial authority,[279] or (iv) sell it themselves.[280] Moreover, the creditor(s) may exercise his rights regardless of who possesses the property.[281]

Under Garro's Model Rules, "after default, the collateral may be sold by public or private sale, with or without prior appraisal, as a unit or in parcels and at any time and place and on any terms but every aspect of such sale including the method, manner, time, place and terms must be conducted in good faith and in a commercially reasonable

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[277] See *ibid.*, arts. 2773 & 2777. After a creditor has acted as administrator of the property as others who are entrusted with full administration, after he has obtained payment of the debt, he is obliged to return to the person against whom the hypothecary right was exercised, in addition to the property, any surplus remaining in his hands after payment of the debt, the expenses of administration and the costs incurred for the exercise of possession of the property.

[278] *Ibid.*, arts. 2778, 2781 & 2782:

> Where at the time of registration of the creditor's prior notice, the debtor has already discharged one-half or more of the obligation secured by the hypothec, the creditor shall obtain authorization from the court before taking property in payment, except where the person against whom the right is exercised has voluntarily surrendered the property. The judgement to surrender or the deed voluntarily made constitutes the creditor's title of ownership. Taking in payment extinguishes the obligation.

[279] *Ibid.*, arts. 2791 & 2793: "A sale takes place by judicial authority where the court designates the person who will proceed with it, fixes the conditions and charges of the sale, indicates whether it may be made by agreement, a call for tenders or public auction and, if it considers it expedient, after enquiring as to the value of the property, fixes the upset price." Additionally, the person entrusted with such sale must observe the rules prescribed in the Code of Civil Procedure.

[280] See *ibid.*, arts. 2784, 2785, 2787 & 2789. A creditor who has met the requirements provided by this law and after obtaining surrender of the property, may proceed with the sale by agreement, by a call for tenders (newspapers or invitation) or by public auction. The creditor shall sell the property without unnecessary delay, at a commercially reasonable price, and in the best interest of the person against whom the hypothecary right is exercised. The creditor shall impute the proceeds of the sale to payment of the costs of exercising the right, payment of the claims prior to his rights, and, finally, payment of his claim. Additionally, where the proceeds of the sale are insufficient to pay his claim and costs, the creditor retains a claim against his debtor for the balance due to him.

[281] See *ibid.*, art. 2751. The CCQ requires the creditor intending to exercise a hypothecary right to file prior notice at the registry office, together with evidence that the debtor has been served as to his intention of exercising his right (See *ibid.*, art. 2757). This notice shall include, among other things, any failure by the debtor to fulfill his obligations, the amount of the claim in capital and interest, the nature of the hypothecary right that the creditor intends to exercise, a description of the charged property, and a call on the person against whom the right is to be exercised to surrender (This surrender may be voluntary or forced. In any case, a creditor who has obtained surrender of the property has simple administration thereof until the hypothecary right he intends to exercise has in fact been exercised. For more detail, see *ibid.*, arts. 2763, 2764, 2765, 2767 & 2768) the property before the expiry of the period specified in the notice (in the case of movable property, this period is 20 days after registration of the notice or 10 days if the creditor intends to take possession of the property) (See *ibid.*, art. 2758).

manner."[282] However, if the secured obligee is not proceeding properly or if he is exceeding his rights to possess or sell the collateral, he may be restrained from proceeding further, and the court may, in addition to such other relief as may be appropriate, order the collateral be sold by judicial process, or in such other manner as may be commercially reasonable.[283]

VII. Publicity of Security Interests

The effectiveness of secured credit depends on the type of public notice system available for non-possessory security interests under the personal property security law of a certain country. Public notice requirements for non-possessory security interests should be comprehensive, simple, efficient and inexpensive in order to achieve the highest degree of effectiveness and sophistication for secured transactions. Moreover, the formalities involved in registration procedures have a significant impact on the efficacy of security interests against third parties, which is why they are so important for secured transactions. Many of the technical features of Mexico's registry system[284] differ from those established under Article 9;[285] however, they are not so different from the publicity and registration approaches followed in Quebec.[286] The three most important changes needed for Mexico's registry system are: (1) substituting the current transactional registration system for a notice filing system;[287] (2) creating or extending the possibility

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[282] "Reform and Harmonization", *supra* note 8 at 144 (art. 86).
[283] See *ibid.* at 147 (art. 93).
[284] See *CCDF*, supra note 16, arts. 2999-3074, for all rules concerning the organization and registration procedures under the Mexican Public Registry system.
[285] See *UCC*, *supra* note 6, ss. 9(9-401)-(9-407), for a detailed description of the filing system in the United States.
[286] See *CCQ* (Book Nine), *supra* note 141, arts. 2934-3075.
[287] For the purpose of this study:

"Registration" and/or "register" mean(s): "To record formally and exactly; ... entered or recorded in some official register or record or list." Black, *supra* note 15, *s.v.* "Register". It also means: "To commit to writing, to printing, to inscription, or the like. To make an official note of; to write, transcribe, or enter into a book, file, docket, register, computer tape or disk, or the like, for the purpose of preserving authentic evidence of." *Ibid.*, *s.v.* "Record".

"Filing" and/or "file" mean(s): "A paper is said to be filed when it is delivered to the proper officer, and by him received to be kept on file as a matter of record and reference." *Ibid.*, *s.v.* "File".

of pre-filing, whereby you can file a notice of intention to create a security interest before such interest is actually created, and additionally, shaping a system where registration of a security agreement to cover multiple and future secured transactions in a single filing is possible; and (3) eventually, modernizing the existing registries by providing them with a sophisticated computerized system that helps their organization locally and nationally.[288]

A. PUBLIC REGISTRATION IN THE PERFECTION OF SECURITY INTERESTS

One of the main concerns of Mexican personal property security law is a fair balance among claims competing for priority in secured transactions. Those people who acquire an interest in an asset of the debtor should not be subordinated to a prior security interest of whose existence they had no means to discover. This goal could be accomplished by giving notice of the security interest to possible future buyers and potential creditors. In Mexico, there are two ways in which notice can be carried out by the secured creditor, depending on the possessory or non-possessory nature of the security interest.[289] For example, if dealing with a possessory security interest, notice would be given by the secured creditor by taking possession of the collateral or by a third party on his behalf.[290] On the other hand, if the secured creditor were to leave the debtor in possession of the goods (non-possessory security interest), then he would have to take some other step to make the security interest public; this could be accomplished by registering the security agreement in the Public Registry.[291]

Most of the times, "registration" and "register" are used when referring to Mexican and Canadian systems and "filing" and "file" when referring to the American system.

[288] See "Reform and Harmonization", *supra* note 8 at 57-58.

[289] See *CCDF*, *supra* note 16, arts. 2858-2862.

[290] *CCQ*, *supra* note 141, arts. 2702, 2703 & 2705: "A movable hypothec with delivery is published by the creditor's holding of the property or title .... The creditor with consent of the grantor, may hold the property through a third person."

[291] See "Reform and Harmonization", *supra* note 8 at 58. See also *CCQ*, *ibid.*, art. 2934, where either type of hypothec (with or without dispossession of the debtor) over movables may be published by means of a registration in the register of personal and moveable real rights.

There are several reasons behind requiring registration of non-possessory security interests; however, the reasons are not the same under civil law and under common law. Under civil law, notice and public registration were provided by legislators to address two problems: (1) a false impression of creditworthiness is likely to result from the appearance of ownership created by possession of the movable *(la possession vaut titre)*; and (2) an owner in possession of the goods might deliver them to a third person in order to defeat the claim of his creditors.[292]

Following the precedent set by French civil law, the Mexican Civil Code reacted to the problem of "ostensible ownership" created by possession by authorizing the possessor to act as if he were the owner of the goods.

> The underlying policy is that an individual's interest in enjoying movable property that is acquired in good faith from someone else that appears to be the owner is more important than recognizing the rights of the person who first owned it or who last owned by wholly consensual transfers. This policy is reflected in the general principle that, except in cases of theft or loss, a third party taking possession in good faith of movable property gets good title.[293]

One of the effects of this rule is to render non-possessory security interests ineffective.[294]

The common law also recognized that non-possessory security interests created some problems regarding their publicity before third persons, but it confronted these problems in a different way; it did not give any advantages to third parties. For example,

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[292] See "Reform and Harmonization", *ibid.* However, the means of overturning the latter transaction are set out in the Mexican Civil Code under the chapter entitled "acts in fraud of creditors" *(De los actos celebrados en fraude de los acreedores)* (See *CCDF*, *supra* note 16, arts. 2163-2179), the remedy is known as "paulian action" *(acción pauliana)*.

"Paulian Action" *(acción pauliana)* is the remedy granted by the Mexican Civil Code to the victim of an illegal act (creditor), whereby he seeks from the judicial authority the nullification or revocation, depending on the case, of the act(s) made by the debtor where he alienates the collateralized goods and when such act led to his insolvency. The effect of this remedy is to obtain a favorable judgement from the court stating the nullification or revocation of the debtor's act(s), making the collateralized goods he had alienated return to his patrimony, and thereby permitting the creditor to be paid with the proceeds from the sale of such goods. See E. Gutierrez y González, *Derecho De Las Obligaciones*, 10th ed. (México: Editorial Porrúa, 1995) at 702.

[293] "Reform and Harmonization", *supra* note 8 at 59; *CCDF*, *supra* note 16, arts. 798-799.

[294] See "Reform and Harmonization", *ibid.*

regarding bona fide purchasers in conditional sales, the common law protected a seller's right of ownership. This approach was based on the ground that no one (buyer) can transfer a right that he himself does not have *(nemo dat quod non habet)*.[295]

Eventually, both the civil law and the common law regimes began to gradually modify their traditional postures by creating statutory exceptions to their general principles *la possession vaut titre* and *nemo dat quod non habet*.[296]

In Mexico, a statutory scheme was created, requiring publicity of non-possessory security interests by registering them under the Public Registry of Property and Commerce. Registration of non-possessory security interests served as a means for opposing all third persons and additionally granted a certain ranking to the secured creditor under the Civil Code or applicable commercial law, depending on the commercial or non-commercial nature of the transaction. If parties to a secured transaction did not register their security interest in the Public Registry as mandated by law, such interest would only produce effects between the parties, since its publication produces declaratory effects[297] but will never be opposable against third persons.[298] Therefore, if a secured creditor failed to register his security agreement, a subsequent purchaser would be entitled to ignore the security interest. Publicity through registration assures subsequent creditors that they can acquire title to movable property free of encumbrances if a security interest subject to registration was not registered; conversely, if the security interest was properly registered, it would also prevent claims of third parties asserting good faith under *la possession vaut titre*.[299]

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[295] See *ibid.* at 60.

[296] For a detailed explanation of the rule *nemo dat quod non habet* and exceptions thereto see E.L.G. Tyler & N.E. Palmer, *Crossley Vaines' Personal Property*, 5th ed. (London: Butterworth & Co., 1972) at 159-208.

[297] See *CCDF*, *supra* note 16, art. 3010(i); see also *CCQ*, *supra* note 141, art. 2944, which similarly states that "registration of a right in the register of personal and movable real rights ... carries, in respect to all persons, simple presumption of the existence of that right."

[298] See *CCDF*, *ibid.*, arts. 3007-3009.

[299] See "Reform and Harmonization", *supra* note 8 at 60.

Accordingly, Quebec law provides that the purpose of publication is to make rights opposable to third persons and that rights shall produce their effects between the parties (hypothec creditor and hypothec debtor) even without publication.[300] Such rights may produce their effects between the parties even before publication, unless the law expressly provides otherwise.[301]

The common law also accepted the public registration requirement as a means to give public notice of non-possessory security interests in order to make them effective against third parties.

For all of the above reasons, public registration has become an extremely important feature of security interests in both legal traditions. However, although both civil law and common law made non-possessory security interests public, it is important to bear in mind that each of them established different sets of rules to address this concern. For example, in contrast to Mexican and Quebec law, under common law, non-possessory security interests are effective against third parties unless otherwise established by statute. This conceptual difference indicates the important role that an adequate registry machinery for the recognition and effectiveness of non-possessory security interests plays in a civil law regime like Mexico's.[302]

Moreover, under the Mexican registry system, publicity of a security interest cannot be separated from its perfection (opposability to all third persons); in other words, there can be no perfection of a non-possessory security interest unless public notice of the security agreement is given to third parties by registering the document in the Public Registry.

Regarding possessory security interests, however, there can be no perfection unless public notice is given to third parties by the creditor or third party taking physical

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[300] In Quebec law, there are no cases where either the existence of the hypothec (its validity) or its effect as between debtor and creditor (its inter party effects) are subordinated to its publication.
[301] See *CCQ*, *supra* note 141, arts. 2941 & 2663.
[302] See "Reform and Harmonization", *supra* note 8 at 61.

possession of the collateral.[303] In addition, a security agreement has to be properly executed in order to be effective.[304] In contrast to the Mexican approach, Article 9 contains a much broader notion of "perfection"[305] where, in addition to the aforementioned requirements, "intermediate categories of perfection" exist, whereby filing can be temporarily delayed or dispensed with altogether, having a certain effect on the obtaining of a given ranking position.[306]

This survey concerning the publicity and registration of non-possessory security interests under Mexican law, Article 9 and the CCQ, leads us to believe that the central issue to be discussed and debated herewith consists of what should be filed and registered, when, where, and for how long. For a clear assessment of these issues, we should examine carefully: (i) the differences between the transactional registration and the notice filing system, (ii) the advantages that notice filing and pre-filing offer in modern secured financing, and finally, (iii) an explanation of the basic features of the Mexican registry system that should be considered for reform.[307]

B. THE "TRANSACTIONAL" REGISTRATION AND THE "NOTICE" FILING SYSTEMS

There are two main types of publicity systems: (1) the transactional registration system, which is the one currently followed in Mexico, where each security agreement must be registered in a Public Registry and there can be no filing before the secured transaction actually takes place; and (2) the "notice" filing system, which is the one adopted by Article 9, where the particulars of a financing statement are filed to a minimum, giving the searcher the right to obtain further information directly from the secured party named in the file.[308]

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[303] See *CCDF*, *supra* note 16, arts. 2858-2862.
[304] See *ibid.*, art. 3021.
[305] *UCC*, *supra* note 6, ss. 9-303(1): "A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken."
[306] See "Reform and Harmonization", *supra* note 8 at 61.
[307] See *ibid.* at 62.
[308] See *ibid.*

On the one hand, public registration in Mexico addresses equally the publicity of real rights *(derechos reales)* in both movables and immovables,[309] where the main purpose is to give knowledge to the whole universality of third parties, including as much information as possible about the extent to which the debtor's assets are encumbered. On the other hand, Article 9 takes a different approach. The main purpose of its notice filing system is to serve the interests of secured creditors by determining the priority of competing claims as of the date of filing, rather than providing notice of secured transactions to all third parties.[310]

Unlike the Mexican transactional registration system, the written document that is to be filed under Article 9 is called a "financing statement",[311] which is not necessarily the same as the security agreement used in Mexico. For example, the formal requirements that are to be included in a financing statement merely include: the signature of the debtor, the addresses of the parties to the transaction, and a statement indicating the types of collateral that are or might be encumbered in the future.[312] We can deduce from this that these statements provide basic information, merely indicating that some sort of secured transaction has been or may be entered into by the parties.[313]

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[309] See *CCQ*, *supra* note 141, art. 2938, as to the rights requiring publication: immovable real rights, personal rights, and movable real rights to the extent prescribed by law.

[310] See "Reform and Harmonization", *supra* note 8 at 63.

[311] See *UCC*, *supra* note 6, s. 9-402(1), where the particulars of a financing statement are described in detail. The description requirements of a financing statement have been stripped to a minimum compared to those of a security agreement.

[312] See *ibid.*

[313] See *CCQ*, *supra* note 141, art. 298, which provides a middle approach whereby applications for registration in the register of personal and movable real rights shall identify the holders and grantors of the rights (who must sign (art. 2984)), state the nature of the rights, describe the property concerned (sufficient description of the hypothecated property, and regarding a universality of movables, indicate the nature of the same (art. 2697)), and mention any other facts pertaining to publication as prescribed by law or by the regulations.

Assuming that the same information is obtained under both publicity systems, either if a potential creditor checks the files directly or simply asks the debtor for details, we must question the advantages offered by the system of notice filing.[314]

1. Advantages of "Notice" Filing over "Transactional" Registration

Although notice filing is not a perfect system, common law commentators believe that it provides some important advantages over transactional registration and thus argue strongly in favor of adopting a notice filing system scheme in transactional registration countries. These advantages include:[315]

a) Speed and Accuracy: The degree of speed and accuracy of the registration process depends on the individual skills of the officers in charge of the Public Registry and on the technological sophistication of such registries. It is believed that a transactional registration system is predestined to involve a vast amount of paperwork. This is certainly true if you compare it with the notice filing system, where instead of requiring that the security agreement be registered in detail, it only requires an abbreviation of the information contained in the financing statement. This permits the registry officers easier handling of the records, additionally lightening the amount of paperwork handled by the registry office. On the other hand, as stated before, a notice filing system is of less assistance to those who inspect the records than the transactional registration system. Article 9's notice filing system informs interested third parties about the secured transaction in a very general form, while at the same time reducing the amount of paperwork involved in the registration process; but unfortunately, because it provides abbreviated information, it is also a system that depends heavily on the

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[314] "Reform and Harmonization", *supra* note 8 at 64.

existence of effective mechanisms for obtaining from the secured party information not provided by the public records.[316]

This disadvantage of the notice filing system becomes apparent when third parties are told in the abbreviated and vague financing statements neither the amount of the secured obligation nor which particular assets are covered. Additionally, even the existence of a security agreement is sometimes uncertain. Article 9 addresses this problem by complementing its filing system with certain mechanisms[317] to assist potential creditors in obtaining information as to the extent of the secured obligation and the collateral subject to prior security interests. However, such mechanisms where more information is provided to potential creditors regarding the debtor's creditworthiness are considered to be really fragile.[318]

If Mexican legislators decide to adopt a notice filing system, they should pay special attention to such disadvantages. In this respect, perhaps they should follow Canadian legislation,[319] where any person with an interest in the collateral (debtor, creditor and others) is allowed to demand from the secured party precise information as to the property affected and the size of the secured debt. Additionally, the courts should be given the power to enforce this obligation on the secured party and to declare the

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[315] See *ibid.*

[316] See *ibid.* at 65.

[317] See *UCC*, *supra* note 6, s. 9-208.

One of the mechanisms adopted by Article 9 is to oblige the secured party of record to supply, upon the debtor's request, additional information of the transaction as to the amount of unpaid indebtedness as of a specified date plus a list of the collateral that needs his approval However, such obligation to supply information is limited by some of the detailed provisions in Article 9 itself. Additionally, there is a great risk for the prospective creditor of being misinformed because all the inquiries concerning the secured transaction must pass through the debtor and the prior secured creditor. Although such disadvantages are self-evident, the drafters of Article 9 thought that requiring that more information be included in the files would be a step backwards and hence defeat the whole purpose of notice filing. No mechanism is provided by which another creditor can force the information on the debtor or the registry officer.
See "Reform and Harmonization", *supra* note 8 at 65-66.

[318] See *ibid.*

security interest unperfected in case the secured creditor fails to disclose the requested information.[320] The courts should also be permitted to enforce criminal or civil penalties for misbehavior of a person or business entity who fails to comply with such obligation. Nevertheless, litigation processes in Mexico are generally slow and may result in a noticeable expense if the costs of the litigation process are added to all other costs generally involved in a secured transaction.[321]

However, aside of the aforementioned disadvantage, Article 9 has other features that support adopting a notice filing system. For example, the system applies voluntary filing of a termination statement upon release of the collateral whenever there is no outstanding secured obligation and/or no commitment to make any further advances. This feature was created so that the record could reflect the true state of affairs, resulting in fewer inquiries by persons consulting the files.[322] This feature may be complemented by conferring express power on the courts to cancel a filing in case of the creditor's refusal to issue a statement of release of the collateral or satisfaction of the secured obligation.[323] Moreover, under Garro's Model Rules, it is established that "if the secured obligee fails to file such termination statement as required, or to send a termination statement within ten days after proper demand thereof, he shall be liable to the obligor for $ ..., and in addition for any loss caused to the obligor by such failure."[324]

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[319] See *UPPSA*, *supra* note 149, ss. 17.
[320] See "Reform and Harmonization", *supra* note 8 at 136 & 137 (arts. 45, 46 & 48), where Garro's Model Rules additionally establishe a 10 day period for the secured obligee to reply to the written demand of information made by the obligor, creditor or any other person with a legitimate interest.
[321] See *ibid.* at 67.
[322] See *UCC*, *supra* note 6, s. 9-406.
[323] See "Reform and Harmonization", *supra* note 8 at 67.
[324] *Ibid.* at 135 (art. 42).

b) Flexibility for Multiple Secured Transactions: The transactional registration system seems to work well in those cases where the collateral consists of equipment or other stable items of property.[325] Consequently, the collateral and the secured debt are clearly identifiable in the record books, leaving third parties with only a limited uncertainty as to the amount of the debt that is still outstanding. However, the transactional registration system has a major weakness because it does not permit filing of a security interest before the actual transaction has taken place (pre-filing). As a result, the transactional registration system fails to accommodate priority positions arising from credit transactions consisting of sequent loans over a certain period of time or when there is a constant shifting of collateral (i.e., accounts receivable and inventory financing, respectively).[326]

Moreover, under the transactional registration system, security interests covering future advances or after-acquired property rank as of the time each individual credit transaction is separately registered. In contrast, the notice filing system allows the secured party to obtain a certain priority status for multiple secured transactions by just filing once, even if the first transaction has not taken place. This method of secured financing is of great importance, since it strongly encourages the repeated extension of credit by allowing a secured party to file a financing statement before the security agreement comes into existence and thus gain priority as of the time negotiations begin or any time thereafter.[327] This feature should be considered for adoption in Mexico.

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[325] See Jackson & Kronman, *supra* note 180 at 1178-1182. They recommend the adoption of transactional registration with respect to equipment.
[326] See "Reform and Harmonization", *supra* note 8 at 68.
[327] See *ibid.*

c) Availability of Pre-filing: The priority of security interests securing future advances and after-acquired property illustrates how the decision to use one publication technique rather than another significantly affects the substantive rights of the parties.[328]

(1) (Future Advance Clauses)

Future advance clauses *(obligaciones futuras)* are recognized and thus valid under Mexican law.[329] However, problems arise in relation to the priority of the secured creditor and the rights of subsequent lenders.[330]

The Mexican Civil Code, under the general principles for obligations, establishes that an optional advance agreement gives rise to an obligation under a "suspensive condition".[331] Therefore, the secured obligation does not materialize until that which is optional for the creditor becomes mandatory for the parties or until the advance is actually made. The disadvantage of this approach can be seen in the following example: In Mexico, when two security interests are perfected through registration, the interest that was first perfected is given priority. Consequently, optional secured advances made after the execution and registration of a subsequent security agreement become subordinated to the latter because a security interest covering a future advance made under an optional clause is not perfected until the suspensive condition materializes. In practical terms, what this approach suggests is that in order to be protected, a secured party, who is willing to give periodic extensions of credit to the same debtor but does not want to make a binding commitment, must examine the records each time he wishes to make

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[328] See *ibid.*
[329] See *CCDF*, *supra* note 16, art. 2870.
[330] See "Reform and Harmonization", *supra* note 8 at 69.
[331] See *CCDF*, *supra* note 16, arts. 1938 & 1939.

subsequent credit advances to ensure that there is no intervening encumbrance in that precise period of time in which he wishes to make subsequent advances.[332]

On the other hand, Article 9 has taken a more appropriate approach, whereby an agreement providing for future advances is considered as a continuous transaction. Thus, the secured party is assured a priority as of the time of filing even if making the future advance is left to his discretion.[333] Therefore, for two security interests perfected through filing, Article 9 would give priority to the one that was perfected under the earlier filing, not to the interest that was first perfected.[334] This approach has two advantages: (1) priority is determined by reference to a precise and publicly filing date, independent of whether and when a security agreement had been entered into, and the optional or mandatory nature of the secured party's commitment to extend credit to the debtor; and (2) allowing the filing of a financing statement prior to signing the security agreement, in other words, pre-filing, opens the possibility for the parties to negotiate a future line of credit where the creditor will be confident that, although some advances are made to the debtor by subsequent lenders, his security interest will still enjoy seniority over new creditors filing financing statements at a later time. As a result, the priority obtained by pre-filing will allow the secured party who had first filed to make future advances without the inconvenience of having to check for filings later than his each time he makes them in order to be protected.

In addition, an optional future advance clause may also have economic advantages. For example, the interest rate and financing charges on loans covered by

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[332] See "Reform and Harmonization", *supra* note 8 at 69.
[333] See *UCC*, *supra* note 6, s. 9-204(3).
[334] See *ibid.*, s. 9-312(5)(6).

these types of clauses are generally lower than those where separate loans are granted to the debtor whenever additional funds are needed.[335]

(2) (After-Acquired Property Clauses)

The advantages of pre-filing provided for future advances also apply to transactions involving after-acquired property clauses. Under such clauses, a security interest may be kept in a shifting stock of inventory, where goods are constantly being acquired and/or sold. Similarly to a future advance clause, a security agreement providing for an after-acquired property clause also gives rise to a security interest subject to a "suspensive condition". Therefore, the secured obligation does not materialize, making the security interest unperfected until the debtor acquires rights to the collateral.[336] It is not until the moment when the condition occurs that the effects of the after-acquired property clause relate back to the date when the clause was entered into.[337] Unfortunately, a problem inevitably arises if we consider that such retroactive effects of the condition cannot affect the rights of good faith purchasers who had acquired rights in the collateral between the time the obligation was contracted and the debtor acquired rights in the collateral. In this case a priority conflict between the creditor, who claims an after-acquired property clause, and the subsequent good faith purchaser would result. The "good faith" or "bad faith" of the purchaser depends on his knowledge of the existence of the after-acquired property clause; nevertheless, he cannot allege good faith or lack of knowledge if such clause was properly registered in the Public Registry.[338]

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[335] See King, "Policy Decisions and Security Agreements under the Uniform Commercial Code" (1963) 9 Wayne L. Rev. 556 at 578-579. See "Reform and Harmonization", *supra* note 8 at 70.
[336] See *CCQ*, *supra* note 141, art. 2670, following such approach.
[337] See *CCDF*, *supra* note 16, art. 1941.
[338] See *ibid.*, art. 1950.

"More significantly, the requirement that the collateral be specifically described in the security agreement calls for a succession of security agreements in order for the security interest to attach to each different type of after-acquired property."[339]

Probably, the best solution to this inventory financing problem would be to validate a "floating charge" so that pre-filing of a security agreement describing the collateral as "inventory" would be sufficient to perfect a series of individual security interests, where some or all of the debtor's inventory is taken as collateral.[340]

However, if pre-filing is to be adopted, then some measures should also be considered in order to prevent abuse by secured creditors. Examples of preventive measures adopted by Article 9 and Canadian legislation are: (i) the debtor should be permitted to cancel the security agreement if there is no outstanding obligation and no commitment to incur obligations by the secured creditor;[341] and (ii) if the secured creditor does not cancel such security agreement, then the registry officer should be allowed to do so upon the debtor's request.[342]

The CCQ should also be considered regarding after-acquired property clauses, namely under "hypothecs on universalities". The first paragraph of Article 2674 expressly states that "a hypothec on a universality of property subsists but extends to any property of the same nature which replaces property that has been alienated in the ordinary course of business of an enterprise."

The major premise is that the acquirer of the property takes it free of the hypothec. In other words, an ordinary course disposition is free of the hypothec. This

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[339] See "Reform and Harmonization", *supra* note 8 at 72.
[340] See *ibid.*
[341] See *UCC*, *supra* note 6, s. 9-404(1); see also *UPPSA*, *supra* note 149, s. 54.
[342] See *SPPSA*, *supra* note 254, s. 50. See "Reform and Harmonization", *supra* note 8 at 73.

premise can be deduced a *contrario* from Article 2700, which provides that where movable property is alienated outside the ordinary course of business, the hypothec may be preserved, and from Article 1714, which protects the title of acquirers in ordinary course dispositions of movables. Here it would seem that the hypothec on present inventory only automatically extends to future inventory of that same nature.[343]

Article 2674, paragraph 2 provides, like in paragraph 1, that "a hypothec on an individual property alienated in the same way extends to property that replaces it, by the registration of a notice identifying the new property." Despite the similarity between them, paragraph 2 is not identical to paragraph 1. In paragraph 2, it appears that the replacement property cannot be of the same nature. Here replacement property is different from property received in exchange (i.e., proceeds). Moreover, no delay is provided within which the aforementioned notice must be registered, which increases the probability that competing rights in the property could be acquired by third persons in good faith that might later be trumped by the first creditor registering a new notice. Articles 2700 and 2954 specify a delay of fifteen days for analogous registrations; nevertheless, it is uncertain whether such delay can be read into paragraph 2 of Article 2674.[344]

In addition to the real subrogation of Article 2674 paragraph 1 into either property of the same nature that replaces property hypothecated as a universality sold in the ordinary course of business, and that of paragraph 2 into property that replaces individually hypothecated property sold in the ordinary course of business, paragraph 3 states that "if no property replaces the alienated property, the hypothec subsists but

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[343] See R.A. Macdonald, *The Law of Security on Property: Part One*, provisional ed. (Montreal: McGill University, 1994) at 123.

extends only to the proceeds of the alienation, provided they may be identified." Such provision applies to each of the first two paragraphs. The term proceeds shall involve cash, accounts receivable, negotiable instruments (i.e., checks, promissory notes), goods received in exchange, property acquired with proceeds (even of a different kind) provided it can be identified, and debt instruments. As a result, proceeds of the alienation probably means any value received as the price (or on account of the price) in an ordinary course disposition.[345]

Presumably, in order to be enforceable against third persons, the hypothec would have to be re-registered as a hypothec on claims, and in order to be collectable against account debtors, it would have to be opposable to them under either Article 1641 or 1642. However, it is necessary to determine whether the date of the re-registered hypothec is the date of its registration as a hypothec upon claims, or the date of the initial registration of the hypothec against the property sold in the ordinary course of business. Unfortunately, the Civil Code provides no answer.[346]

VIII. The Registration Mechanism Under the Mexican Public Registry of Property and Commerce

A. UNDERSTANDING THE PUBLIC REGISTRY

The word registry *(registro)* has different legal meanings under Mexican law. It may signify: (i) annotation or registration made over a certain thing; (ii) the book(s) where registration is made; and/or (iii) the registry office in charge of the registration process.[347]

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[344] See *ibid.* at 124.
[345] See *ibid.* at 126.
[346] See *ibid.* at 197.
[347] See Colín Sánchez, *supra* note 123 at 17.

The Public Registry of Property and Commerce is a governmental institution. Its main purpose is to publicize all legal acts required to be registered under civil and commercial law, while protecting the property rights of society regardless of whether it deals with real or personal property, thereby granting legal security to Mexicans.[348]

This publicity is to be achieved by registering legal acts that refer to ownership, possession and other real rights over immovables and movables. Here, the world is put on notice of existing interests in the property in question. All interested third parties are given direct access to its files and records. They have the right to view every document existing in the office's files and to obtain any certificates or written notices as evidence.[349] Thus, they can ascertain the real legal status of the property they are investigating, together with the property's prior history of transmissions or modifications.[350] This publicity principle prevents people who have over a certain property any rights that have not been published from outranking those parties having published rights. If a property right is properly registered, every person has the right-obligation to make himself aware of its existence and content. All these features make the Public Registry an important technical-juridical institution in Mexico. Finally, government intervention is seen as indispensable to inspire confidence in the people seeking to protect their property rights by registering them in this institution.[351]

The Civil Code is the immediate source of law giving rise to the Public Registry. Consequently, it regulates the organization, activities and proper functioning of the registry. It is the substantive law that creates the property right. However, it is not the only law that regulates the registry. Each state's *Reglamento del Registro Público de la Propiedad y del Comercio* (Regulation of the Public Registry of Property and Commerce or RRPPC) together with the Commercial Code and the *Reglamento del Registro Público*

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[348] See *ibid.*
[349] See *ibid.* at 81.
[350] See *ibid.* at 17.
[351] See M. Castro Marroquín, *Derecho De Registro*, 1st ed. (México: Editorial Porrúa, 1962) at 43.

de Comercio (Regulation of the Public Registry of Commerce or RRPC), which operate federally for registration of commercial acts, are the mediate sources of law. The RRPPC is the procedural law that protects the property right.[352] Public services provided by the Public Registry of Commerce are to be carried out by the same registry offices in charge of the Public Registry of Property. Registration is a matter of state law and therefore may vary from jurisdiction to jurisdiction.[353]

The goals of the registration procedure, that is, the effects of registering, can be classified as principal and accessory. The principal goals can be sub-classified as immediate and mediate. For example: (i) the principal immediate goal is the publicity of the legal act(s), which is achieved by their registration in the proper book or file; (ii) the principal mediate goal is the legal security provided by registration of the legal act(s) through its legitimization by virtue of the Registry's public faith. The accessory goal of the registration procedure is that these files shall constitute a particular and privileged means of evidence on which people may rely.[354]

Just as a notary gives legality (legal validity) and authenticity (legal existence) to all legal acts that by law require his intervention, the registry officer gives legitimacy (legal fact) and publicity (opposable to third parties) to all legal acts that are required to be registered. Both the notarial and registration procedures are necessary as external requirements provided by law. The first gives validity to the effects of an act between the parties, and the second gives validity to the effects of the act against third parties, including the government enacting and maintaining the Registry. After a legal act has been legitimized through registration, it shall be considered as a legal fact until its

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[352] See Colín Sánchez, *supra* note 123 at 18-19. See also *Ley Reglamentaria Del Registro Público De La Propiedad Y Del Comercio Para El Estado De Nuevo León* (Regulation of the Public Registry of Property and Commerce for the State of Nuevo León or RRPPC-NL) art. 58. The RRPPC-NL was published in the State's Official Gazette on 22 January 1972.

[353] See *Commercial Code*, *supra* note 32, art. 18. See also *Reglamento Del Registro Público De Comercio* (Regulation of the Public Registry of Commerce or RRPC) arts. 1 & 32. The RRPC was published in the Federation's Official Gazette on 22 January 1979.

[354] See Colín Sánchez, *supra* note 123 at 76 & 78.

registration is either canceled or declared void by a judicial authority. Third parties may benefit in a similar manner: if an act is required by law to be registered and the party obliged to do so does not comply with this requirement, then the act will not have any legal consequences as against third parties. The same principle that states that ignorance of the law is not a valid excuse for not complying with it whenever it has been duly promulgated and made public applies to the publication of rights where ignorance of the registered rights does not benefit the ignorant party.[355]

Unfortunately, the Public Registry in Mexico is badly organized. It might even be said that there has been great indifference towards solving its problems and achieving its proper functioning. Someone paying a visit to one of the registry offices is likely to be confronted by great deal of absolute abandonment, dust, destruction, piles of books in bad shape, excessive paperwork, lost documents, delays, immorality, and other factors believed to derive from the inveterate bureaucracy that frequently destroys governmental institutions.[356]

The Mexican community, especially credit institutions and notaries, have been claiming for many years that there is a clear and urgent necessity to pay more attention to registry activity. Unfortunately, their insistent claims and protests have had very few positive results, if any, and hence the majority of such institutions remain unchanged. Nowadays, there is great concern as to the prestige of these registries and the confidence or legal certainty they provide for Mexicans. One of the principal reasons why such an important service as the Public Registry is so badly organized and considered to be archaic is because the registries were unprepared for Mexico's rapid economic, industrial and commercial transformation and population increase. Contrary to its purposes, registries now frequently provide fertile terrain for fraud. As a result, there is constant litigation as to property, ownership and legitimate possession.[357]

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[355] See Castro Marroquín, *supra* note 351 at 86-95.
[356] See Colín Sánchez, *supra* note 123 at 64.
[357] See *ibid.* at 65.

The current registry system in Mexico does not respond to modern needs of security and rapidness for the research people conduct on the state of movables and immovables. Surprisingly, the registry system has not changed significantly since 1870, when it was created. To make matters worse, there is a considerable, constant and never-ending daily increase in the volume of tasks that the registry office has to perform. Moreover, in an office where the need for technically specialized personnel is obvious, where there is a great deal of cases to be dealt with, and where the level of responsibility is very high, it is startling that remuneration remains low. The government, with all its public earnings, should be responsible for improving the registry.[358] In the area of personal property, most registries remain underdeveloped and require a renewed commitment to the preservation of property rights. The modernization of the Mexican economy, together with an increase in the value of personal property as collateral for commercial loans, is now forcing Mexican legislators to address the need to protect the rights of parties taking non-possessory security interests in personal property. Although the section of the registries devoted to personal property transactions is currently of relatively minimal significance and the number of personal property registrations represent only a small fraction of the total registrations, "Mexico must implement and preserve a registry system that protects the legal mechanisms which create property rights, since the value of these rights is greatly undermined if the registries do not function correctly."[359] Unlike civil transactions between banking institutions and consumers, the main problem in Mexico's inadequate registries corresponds to cases where parties are interested in creating rights in personal property in connection with commercial financing. However, we should be aware that this deficiency stems not only from the registry system but also from the current substantive law and commercial practice, which according to Part One generally do not require registration of these rights

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[358] See *ibid.* at 66.
[359] Wilson-Molina, *supra* note 11 at 16.

in all instances. It is necessary that these three function in harmony in order to protect effectively the rights of those with interests in personal property in commercial transactions.[360]

B. DOCUMENT TO BE REGISTERED

Contracts that require registration do not usually distinguish between commercial and civil transactions. The registration process does not make any distinction either. Furthermore, registered documents, except for *habilitación o avío* and *refaccionario* loans, do not usually indicate which legal mechanism was used to create the rights in property (e.g., commercial pledges created under the LGTOC, civil pledges created under the Civil Code, or banking pledges created under the LIC). The vast majority of these registered documents are form contracts that only contain a description of the collateral, information about the debtor, and payment criteria. This ambiguity carries with it the apparent advantage that it may be possible for lawyers to argue for the application of the most favorable mechanism. This is seen in automobile financing, where the transaction can be considered as a banking pledge under the LIC if a bank grants the loan and the same contract may also comply with the requirements of the civil pledge under the Civil Code.[361]

C. PLACE OF REGISTRATION

There are no hard-and-fast rules as to the place of registration of personal property. Liens in personal property are frequently registered at either (i) the debtor's residence or principal place of business, (ii) the lender's residence or principal place of business, (iii) the location of the goods, or (iv) the place where the contract was executed. It seems that the place of registration may be set voluntarily by the parties to the transaction. Unfortunately, rules concerning the appropriate place to register have not

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[360] See *ibid.* at 17.

been much of a priority for Mexican legislators, since commercial lending secured with personal property is not particularly common at this time.[362]

Wilson-Molina states that in Mexico there is a tendency to register only in the jurisdiction where the lender's place of business is situated. There are three main reasons for doing so. First, the location of the lender is usually the location where the contract was executed. Second, and probably the most influential, the lender's residence is probably the most convenient location to register. Third, it does not matter where the contract is registered because the lender will not be penalized by the law if he registers the contract in a location that is unlikely to be searched, since any registration appears to be universally valid.[363]

The state's registry system is frequently divided into judicial districts, or municipalities. Each of the districts has its own Public Registry and each of the judicial district registries is autonomous.[364] Nuevo León, one of the largest and most industrialized states in Mexico, opted to employ existing judicial districts for the location of its registries.[365] The RRPPC for the state of Nuevo León (RRPPC-NL) in Article 23 establishes that the registration of a security interest must be done in the registry office of the district where the collateral is located; however, it establishes as an exception that which is provided by Article 23 of the Commercial Code, namely, that such registration must be done in the registry office that has jurisdiction over the merchant's domicile.[366]

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[361] See *ibid.* at 17 & 18.
[362] See *ibid.* at 20.
[363] See *ibid.*
[364] See *ibid.*
[365] See *RRPPC-NL*, *supra* note 352, art. 1.
[366] The term "merchant" embraces both individuals and corporations. See *Commercial Code*, *supra* note 32, art. 3.

Mexican legal scholars agree that the Mexican rules providing for the registration of non-possessory security interests in personal property are imprecise. For example, if the collateral given as pledge gets displaced from where it was initially located, then it would be best not to register it in a specific place. However, if the pledge is registered in several places, it would not generally be possible for a third party to consult all the Public Registries established throughout the country in order to know whether such movable is encumbered or not.[367]

Another significant problem is encountered by Mexican attorneys since a properly registered personal property security interest will be valid throughout the state, and perhaps throughout the country. Therefore, the place of registration usually does not matter to the lender since a single registration will produce the same effect as twenty.

"A potential problem created by nation-wide validity of registrations is the possible encouragement of careless registration practices, or registration at the most convenient location even though it may not be the best place to register in order to give notice to third parties."[368] Such validity of nation-wide registration without a system that links the country's registries together is incomprehensible and creates enormous potential for fraud and abuse.[369]

Perhaps from the viewpoint of the person searching the files, it would be most convenient to establish a single registry for the secured transactions of the whole country. Moreover, considering that registration mechanisms in Mexico are mostly not computer-based, the most convenient and effective place for registration must be chosen with regard to the cost-efficiency considerations related to the administration of Public

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[367] See R. Sánchez Medal, *De Los Contratos Civiles*, 10th ed. (México: Editorial Porrúa, 1989) at 470-472.
[368] Wilson-Molina, *supra* note 11 at 21.

Registries.[370] Article 9 addresses this issue by offering each American state the alternative to choose between central (state) filing and local (county or township) filing, or a combination of both. Under such scheme, each state is free to decide whether to centralize the files on a state-wide basis or to scatter the files in local filing units.[371]

Probably it would be best for security agreements to be registered in the place where a creditor would normally look for information concerning the financial status of the debtor's assets; generally this would be the place where the debtor's domicile or principal place of business is located. Additionally, multiple registrations should be allowed in cases where items that comprise the collateral are located in different places, when the movable collateral can be displaced, or if the debtor has more than one place of business.[372]

Under Garro's Model Rules:

> The proper place to file in order to perfect a right of security is the registry office with jurisdiction over the place where the obligor's domicile or principal place of business is located. If the items of collateral are located in various places, or if the obligor has more than one principal place of business, the proper place to file is each of the registry offices with jurisdiction over the place where the items of collateral are kept or where the obligor has its places of residence or business.[373]

Furthermore, Mexican law fails to provide for the effects of a registration in case the debtor changes his residence. It also fails to provide for the effectiveness of a registration in case the collateral is moved from its original location.[374] What Mexican

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[369] See *ibid.*
[370] See "Reform and Harmonization", *supra* note 8 at 73.
[371] See *ibid.* at 74.
[372] See *ibid.* at 75.
[373] *Ibid.* at 133 (art. 32).
[374] See *UCC*, *supra* note 6, s. 9-401 providing for different alternatives in the event the debtor changes his residence or place of business, or if the location of the collateral changes within the state, whichever place controlled the original filing. According to the first alternative rule, if "the original filing was made in the proper place, it continues effective after any of the aforementioned changes. Under the second alternative, a filing made in the proper place continues effective for four months after the change to another county of the debtor's residence, place of business, etc. The filing becomes ineffective thereafter unless a copy of the

law does provide, besides the assumption of collateral immobility, are civil and criminal sanctions upon the debtor in case he does move the collateral.[375] Additionally, Mexican law does not provide for the effects in case registration is made in the wrong registry office. Here, it would be wise to follow the approach established by Article 9 and thus grant limited effects to a filing wrongly made but that was done in good faith.[376]

Garro's Model Rules could help address these issues too. For example, in case there is a change of location of the collateral, domicile or principal place of business of the obligor, whichever controlled the original registration, a registration that was made in the appropriate registry office shall continue to be effective for four months after such change. If within this period the secured obligee does not register in the new registry office a signed copy of the financing statement, then the registration will become ineffective. Nevertheless, after the expiration of the four-month period a right of security may also be perfected in the new registry office; however, in such a case perfection will date from the time of perfection in the new registry office.[377] In addition, these Model Rules provide that a registration erroneously made in an improper place or not in all of the places required but that was made in good faith shall nevertheless be granted limited effects.[378]

All these problems will be remedied once the registries are modernized and computer technology is introduced to create electronic databases not only to register but also to search for personal property secured transactions.

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financing statement signed by the secured party is properly filed within said period." If the filing is made after the four months have elapsed, perfection will occur only at the time of the second filing. It is clear, however, that "a change in the use of the collateral does not impair the effectiveness of the original filing."

[375] See *LGTOC*, *supra* note 33, art. 329.

[376] See *UCC*, *supra* note 6, s. 9-401(2). See also "Reform and Harmonization", *supra*, note 8 at 75 - 76.

[377] See *ibid.* at 133 (art. 34).

[378] See *ibid.* (art. 33).

D. TIME LIMIT FOR REGISTRATION AND EXPIRATION

Within a registration system, there are also some other aspects that should be considered to make the system's operation more efficient; for example: (i) whether there should be a time limit for registration; and (ii) whether the validity of such registration will expire after a certain period of time.[379]

First, given that subsequent secured creditors are adequately protected by the rule that allows them to enjoy priority over prior unperfected security interests, it is unnecessary to impose a time limit for the parties to register a security interest. Under Mexican law, not only is registration optional for the parties, but so is the time within which to do it; therefore, it is up to the secured creditor to measure the risks of possible subordination to a subsequent creditor(s).[380]

Secondly, Mexican law establishes that the registration will remain effective until its cancellation is requested.[381] This makes the time of expiration extremely vague. Contrary to this, Article 9 establishes a maximum filing period of five years for its lapse, and additionally, gives the parties the right for its renewal.[382] The reason for establishing a specific period for expiration is related to cost-benefit considerations regarding the operation of the registries in order to avoid problems of storage and retrieval of information. However, it might be preferable if parties were given the liberty to specify in the security agreement a longer or shorter period of time for which the security interest would remain valid, according to the nature and circumstances of the secured transaction.[383] As a result, potential creditors would be better informed as to the duration that the debtor's collateral remains encumbered. This would allow potential creditors to

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[379] See *ibid.* at 76.
[380] See *ibid.*
[381] See *CCDF*, *supra* note 16, arts. 3028 & 3030.
[382] See *UCC*, *supra* note 6, s. 9-403(2); see also *CCQ*, *supra* note 141, arts. 2937 & 2942, regarding the "renewal" of publication of a right by notice in order to preserve the opposability of the right at its original rank.
[383] See *SPPSA*, *supra* note 254, s. 48(2), which gives the parties to a secured transaction the choice of number of years they wish the registration to be in effect.

make a more informed decision about whether to extend credit, while still giving the secured creditor the time-protection sought. Despite all these considerations, the specific number of years for which a registration should remain valid will depend greatly on the administrative facilities and the technological development of the Mexican registry system.[384]

Garro's Model Rules confront this duration of registration issue by establishing a five-year period for the effectiveness of a registered financing statement. However, a continuation statement may be filed by a secured obligee within six months prior to the five-year expiration date, making the original statement effective for five more years after the last date in which the original registration was supposed to expire.[385]

E. INDEXING OF FILES

Registration is a two-step process. First, the documents are integrated into portfolios and filed numerically by inscription number. Second, the debtor's name is entered into an alphabetical index. An interested party may conduct an inquiry at the registry either by using the debtor's name[386] or by requesting documents by the inscription number if he happens to have this information. Encumbrances on personal property are kept in a card catalogue index. Unfortunately for the people requesting information using the debtor's name, this index is not consistently updated. Therefore, the registration number is apparently the only way to access currently registered personal property liens. This disadvantage could be remedied by introducing computer technology into the index system.[387]

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[384] See "Reform and Harmonization", *supra* note 8 at 77.
[385] See *ibid.* at 134 (arts. 35, 37 & 38).
[386] See *RRPPC-NL*, *supra* note 352, art. 20.
[387] See Wilson-Molina, *supra* note 11 at 19 & 20.

In Mexico, indexing the registry files according to the name of the debtor presents other inconveniences too. For instance, someone (e.g., potential creditor) searching the registry's files in order to discern whether there are any security agreements under the debtor's name relating to the class of collateral with which the searcher is concerned might by surprised and discouraged to learn that there are many names similar to the one he is seeking. Therefore, changes have to be made to the registry system to ensure that the names being registered and searched are accurate and complete. Registry officers should be granted the authority to refuse documents that are presented for registration but do not comply with the basic formalities required by law. Although this recommendation is followed by Mexican registries,[388] it does not solve the problem completely. If Mexico continues indexing security agreements according to the name of the debtor, given that names of individuals are frequently similar or identical, it is inevitable that the courts will confront this problem.[389]

Another solution to this problem might be to allow the parties to use serial numbers for certain types of collateral (e.g., motor vehicles, mobile homes, trailers, boats and airplanes), when held by the debtor as consumer goods, together with or instead of giving the debtor's name for searching files.[390]

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[388] See *CCDF*, *supra* note 16, art. 3021.

[389] See "Reform and Harmonization", *supra* note 8 at 78.

[390] R.C.C. Cuming, "Public Registration of Security Interests in Personal Property: Some Recent Canadian Developments" (1985) 35 Revista De La Facultad De Derecho De México 147 at 167 [hereinafter "Some Recent Canadian Developments"].

> Serial number registration provides a solution to the so-called *A-B-C-D* problem. For example, if *A* takes a security interest in an item of collateral owned by *B* and *B* then sells the item to *C*, who offers it as collateral to secure a loan from *D*, unless *D* can use the serial number of the collateral as a search criterion, all he can do is to obtain a search result using *C*'s name as the search criterion. Since *B*, not *C*, is the debtor named in *A*'s registration, *D*'s search will not reveal *A*'s security interest. If *D* can use the serial number of the collateral as the search criterion, his search will reveal *A*'s security interest if *A* has complied with the requirements that the serial number be used in the collateral description on his financing statement.

F. COMPUTER TECHNOLOGY IN REGISTRY SYSTEMS

As secured credit increases, problems like scarce storage space for all the security agreements registered are likely to arise. This will necessitate: (i) a modern computerized registry system to operate in a much more efficient manner than the current manually operated one; (ii) making computer system benefits available to ordinary users;[391] (iii) the availability of trained registry personnel with expertise in computer programming, who must be well remunerated; (iv) construction of decent, adequate and well equipped registry offices; (v) obliging everybody to strictly comply with the current laws and applicable regulations; and (vi) promoting any necessary reforms.[392]

Article 9 was developed in the 1950s, when electronic storage and retrieval of data were generally not available. Although the conceptual structure of the Canadian PPSAs was heavily influenced by Article 9 of the UCC, since Canada began its personal property security law reform a decade later, it was to be expected that the PPSAs would be designed to function in the context of central, computerized registry systems.[393] "The Canadian personal property registries are the most advanced in the world."[394] There is no jurisdiction in the United States that has a personal property security registry as technologically sophisticated as the Canadian registries.[395] Since 1976, when the first computerized system was fully implemented, all personal property security registries in

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See R.C.C. Cuming, "Computerization of Personal Property Security Registries: What the Canadian Experience Presages for the United States" (1991) 23 UCC L.J. 331 at 333 [hereinafter "Computerization of Registries"].

[391] See "Reform and Harmonization", *supra* note 8 at 78.

[392] See Colín Sánchez, *supra* note 123 at 68.

[393] R. Buckley & R.C.C. Cuming, "Personal Property Security Law in Canada: The Revolution is Nearly Complete" (1998) 72:12 Australian L.J. 918 at 919.

[394] See *ibid.*.

[395] The provinces of Saskatchewan, Alberta and British Columbia are said to have the most efficient registry systems in Canada. See "Computerization of Registries", *supra* note 390 at 335.

Canada have been computerized.[396] Canada is the leader in computerized registries for personal property security, so perhaps Mexican legislators should examine the policies and advantages of adopting computer technology for the Mexican registries modeled on the Canadian approach.[397]

The benefits of a computerized personal property registry are many; however, some problems also exist.[398] For instance, one might assume that the primary advantages associated with such computerization would benefit the administrators of the systems by reducing the cost of record storage and retrieval; this is partially true. But in addition to cost reduction, revenues are dramatically increased to the point that some systems produce significant income for provincial governments. Profits are not produced by high registration fees; rather, they result from increased utilization of the computerized systems. Professor Cuming states that "while cost reduction is a positive by-product of a computerized system, the primary beneficiaries are the users of the systems."[399] Computerized registry systems have brought speed and reliability to registrations, giving satisfactory search results and improving the efficiency in personal property secured financing.[400]

In Canada, all registrations are effected in a single central registry in each province, except for registration of security interests in fixtures. In some provinces,

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[396] See *ibid.* at 331 & 332.

[397] For an example of such a computerized registry system, see the web site of Quebec's "Registre Des Droits Personnels Et Réels Mobiliers", online: RDPRM <http://www.rdprm.gouv.qc.ca> (date accessed: 15 February 2000).

[398] For a better and more complete understanding of the problems solved by computerized personal property registries and some other new problems created with its implementation with regards to registration delays, collateral serial number registration, detailed accuracy in registration and search criteria, individual and artificial body debtor registrations and searches, and what is considered to be seriously misleading in the context of registration-search criteria, see R.C.C. Cuming, "Modernization of Personal Property Security Registries: Some Old Problems Solved And Some New Ones Created" (1983/84) 48 Saskatchewan L. Rev. 189-229 [hereinafter "Some Old Problems Solved"].

[399] "Computerization of Registries", *supra* note 390 at 334.

access to the central registry can be obtained from regional government offices or court houses. However, in all cases, actual registration occurs at the central registry. Of course it would be possible to have computerized regional registry offices, but this would not carry any benefits other than local employment. Additionally, some important disadvantages might result.[401] Professor Cuming states that "the belief that local registries are more suited to the registration of security interests in certain types of collateral is completely outdated. Efficient electronic access to a central registry provides all of the benefits of local registries without the cost and inefficiencies endemic to them."[402]

In some provinces, registrations and searches can be done by remote computer access (simple PC equipment and modem) from any place where long distance telephone communication is available.[403] However, this remote computer access system cannot be used to register financing change statements that modify or discharge a registration, since such system gives direct access to the registry database; the ability to modify or discharge a registration might lead to abuse. Users may obtain direct access to the registry for registration or searches, upon payment of the corresponding fees, by going to a regional government office or to the central registry, by mail, by telephone and by facsimile request. Moreover, since human involvement is unnecessary for remote computer searches, they can be done even when the registry is closed. Additionally, immediate

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[400] See *ibid.* at 334 & 335.
[401] See *ibid.* at 335 & 336.
[402] *Ibid.* at 336.
[403] See Quebec's RDPRM, *supra* note 397.

access to the registry for either registration or searching will reduce delays in closing a transaction or releasing funds.[404]

Notice registration is another feature associated with Canadian registries.[405] The registry contains simple documents or computer screens of information (called "financing statements") that provide basic information about the secured party and the debtor, and a generic or specific description of the collateral.[406] The registry is not necessarily a registry of a particular security agreement; it may also register existing and potential security interests in present or future property of the debtor or prospective debtor.[407] This notice registration feature brings with it several important advantages:

> It provides a greater measure of confidentiality of business information than is permitted in a registry that requires the filing of the agreement between the parties. The secured party need not release the details of a security agreement with respect to which a financing statement has been registered except upon demand by the debtor or other persons with interests in the property. A single financing statement can relate to one or more security agreements. Indeed, it is possible that a properly drawn financing statement can meet registration requirements for many security agreements between the same parties entered into over a period of several years.[408]

Another important benefit of computerized registration is that the need for statutory limitations on the duration of registrations is eliminated. Since storing financing statements is of no concern in a computerized system, the need to clean out the system is greatly reduced. Not surprisingly, some Canadian PPSAs allow the registering party to choose the period that he wishes for the existence of the registration. For

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[404] See "Computerization of Registries", *supra* note 390 at 336.
[405] *CCQ*, *supra* note 141, art. 2983: "application is made by the presentation of a notice, unless otherwise provided by law or the regulations."
[406] *Ibid.* art. 2981: "Applications for registration ... in the register of personal and movable real rights identify the holders and grantors of the rights, state the nature of the rights, describe the property concerned and mention any other fact pertaining to publication, as prescribed by law or by the regulations under this Book."
[407] See Buckley & Cuming, *supra* note 393 at 920.

example, in British Columbia, the registering party may choose any period of full years between one and twenty-five, or even infinity. The choice of unnecessarily long registrations is controlled in two ways. First, the registration fee is commensurate with the duration of the registration. Again, in British Columbia a registering party pays $3 as a processing fee and $5 per year, or $400 for infinity. Nevertheless, the right to select a long period of registration, together with the ability to register a financing statement without the debtor's signature and before a security agreement exists, increases the opportunity for abuse. This problem has been addressed by giving affected persons the right to have an unjustifiable registration amended or discharged by the registrar in case the registering party does not respond to his demand, unless the latter obtains a court order requiring that the registration be maintained.[409]

The advantages of a printed verification statement and of discharging a registration are also clear. When a document is registered, the computer automatically prints out a verification statement containing the information entered into the database, and it is immediately sent to the registering party. Such verification statement has two advantageous functions: (1) it provides a fail-safe way for a registering party to determine whether the information contained in the database of the registry regarding his registration is accurate; therefore, errors on the part of either the registering party or registry employees can be immediately identified and corrected; and (2) when a secured party wishes to discharge a registration, all he needs to do is to send the discharge verification form to the registry. There are no clerical costs for preparing the discharge, and there is no fee charged by the registry to discharge the registration. Experience in the

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[408] *Ibid.*

[409] See "Computerization of Registries", *supra* note 390 at 337 & 338.

Saskatchewan shows that this approach has greatly increased the number of registrations that are voluntarily discharged by secured parties.[410]

A central aspect of any registry is the system that is used to catalogue and retrieve the information it contains, the so-called "registration-search criterion". Canadian systems present two different registration-search criteria in the registration of secured financing transactions: (1) the debtor's name, and (2) the property in which the security interest has been taken as collateral (serial numbers). Using the debtor's name as a registration-search criterion is an essential aspect of a modern system. The reason for this is that there are several important features of the system that would not function on the basis of a collateral description registration-search criterion; for example, where the collateral is inventory or accounts. Since in these situations it is not possible to provide anything more than a generic description of the collateral, the debtor's name is the only functional approach. However, a system that uses only the name of the debtor as the registration-search criterion has a fundamental weakness; it does not protect a third party not in the position to obtain a search of the registry based on the debtor's name because the existence or identity of the debtor is unknown to him. Therefore, where collateral is property that has an active resale market (e.g., motor vehicles, boats, aircraft, recreation vehicles and large farming equipment), the need for a system that offers collateral description as a registration-search criterion becomes particularly acute. Under most Canadian systems, such property held as consumer goods must be described by serial number (e.g., for motor vehicles, the vehicle identification number provided by the

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[410] See *ibid.* at 338 & 339.

manufacturer) if full protection is desired, that is, priority over subsequent buyers and secured parties.[411]

There are also some other peculiarities involved in a computerized registry system, as opposed to a manually operated one, that are worth mentioning. First, the actual search in a computerized registry is done electronically; therefore, ad hoc application of human discretion and judgement is not possible. In using computer technology, users must be aware that a close search is not good enough. As a general rule, the criteria for registration must be the same as the criteria for searching. For example, "if the debtor's name is registered as John P. Smith but his correct name, which is used by a third party as a search criterion, is John P. Smyth, the registration and search criteria do not match, and, unless special features are built into the computer program of the registry, disclosure of the registration will not result."[412] However, this issue is not unique to computerized registry systems; it also arises in the context of manual systems.[413] A simplistic approach towards this issue could be to conclude that the registration must be deemed invalid, since the debtor's name was not correctly registered. Professor Cuming argues that "this approach, however, is commercially and politically unacceptable",[414] and that the consequences derived from invalid registrations can be significant in commercial terms. Unfortunately, in practice, errors in registering names or the serial numbers of collateral cannot be eliminated, and refusal or failure to accommodate these realities will result in public rejection of computerized registries.[415]

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[411] See Buckley & Cuming, *supra* note 393 at 920 & 921.
[412] "Computerization of Registries", *supra* note 390 at 339.
[413] See McDonnell, "A Reevaluation of Public Notice Under Article 9 of the Uniform Commercial Code" in *Secured Transaction* (1980) U.C.C. Serv. [Bender] ch. 6C, 6C-40-6C-50.
[414] "Computerization of Registries", *supra* note 390 at 339.
[415] See *ibid.*

Before these problems arose, the drafters of the Canadian PPSAs and the designers of the computer programs for the personal property registries were already aware of their possible existence. Therefore, they designed systems that, given the profile of the users of the system, could accommodate a reasonable level of human error.[416] For example, Saskatchewan's PPSA provides that the validity of a registration is not affected by a defect, omission, or error unless any of these makes the registration "seriously misleading".[417] The test of validity presented by the PPSA is an objective one, where its application involves a determination as to whether a person who obtains a search result using the correct name of the debtor or the correct serial number of the collateral would be misled by an error on the part of the registering party. Therefore, in Saskatchewan, if a search using one of these two criteria shows a registration that is a "close similar match", it must be determined in each case whether a person who obtains the search result disclosing the registration as a close similar match would be seriously misled by the differences between the information in the disclosed registration and the search criterion used by such person.[418] As a result of the aforementioned example, "under the Saskatchewan system, a search based on the name John P. Smyth as the search criterion would disclose as a similar match a registration based on the name John P. Smith as the registration criterion. The designers of the program employed a coding system that identifies names in the data base that are similar to the search criterion."[419] This could result in disclosure of a large list of close similar matches if many registrations are similar to the search criterion, and a person cannot be expected to follow

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[416] See *ibid.*
[417] See *SPPSA*, *supra* note 254, s. 66(1).
[418] See "Computerization of Registries", *supra* note 390 at 340.
[419] *Ibid.* at 341.

up on all of them to determine whether one of them might be the person he is looking for.[420]

> In order to reduce the number of close similar matches to a useful level, the system goes first to the last name and then refines the list by coding on the first letter of the first name and the first letter of the second name. Another measure taken to reduce the volume of close similar matches is to select only on the basis of the order of the first letters of the first and middle name of the debtor.[421]

These approaches are also used for serial number registrations. For example, the Saskatchewan computer program is designed to employ a coding routine under which alphabetic characters are converted into numeric characters having a similar physical appearance (e.g., I and L become 1; Z becomes 2; S becomes 5). The result can clearly be foreseen; a search using the correct serial number of a good (e.g., motor vehicle) will show as a close similar match a registration containing errors in registering certain alphanumeric characters of a serial number.[422]

> Because of the structure of names of artificial legal persons (generally corporations), the coding system used in the context of names of debtors who are natural persons cannot be used. The special coding system applicable to debtors who are artificial persons, however, has been similarly designed to ensure that registrations are disclosed even though they contain some minor differences between the name registered and the name used as the search criterion. For example, all frequently encountered, nondescriptive words, numbers, and abbreviations, such as Co., Company, Corp., Corporation, Div., Division, Inc., Incorporated, Ltd., Limited, Holdings, Brothers, Canada, Distributors, Manufacturing, East, and West, are excluded from the code used to search the data base.[423]

Credit grantors and buyers can be expected to rely on the information contained in the registries; nevertheless, a registry cannot guarantee that the information supplied to it by registering parties is correct. However, registries must guarantee a secured party that

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[420] See *ibid.*
[421] *Ibid.*
[422] See *ibid.*

the information he supplied as part of a registration is properly registered in the registry database.[424]

> Further, it must guarantee persons searching the registry that the system fully and accurately discloses the information in the registry relating to the registration criterion (debtor's name or serial number of goods) they have used in their searches. Without these guarantees, users of the system will lose faith in it. For this reason the Canadian systems provide that anyone who suffers loss as a result of an error or omission in the operation of a registry can recover their losses from the registry.[425]

In some provinces the amount recoverable is limited; however, such limits are set very high. This recovery approach does not include liability with respect to online registrations and searches. Canadian experience demonstrates that properly designed systems reduce the incidence of loss to negligible levels. For example, under the Saskatchewan system, which began operations in 1981, only one claim has been paid, resulting from a key edit error made during the first day the system was in operation[426]

Consequently, the computerization of personal property security registries in Canada has been a positive experience, since these systems are considered to be extremely reliable and widely used. The fees charged for the services provided by the registries are modest; yet the system makes some profit for the provincial governments.[427] This success should be taken into account by Mexican legislators in their aim of implementing computer technology in Mexico.

In order to implement Canada's central registration approach, Mexican legislators should first begin in the major cities and then gradually expand to the rest of the country. Unfortunately for Mexico, the current economic situation will hinder public registry

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[423] *Ibid.* at 342.
[424] See Buckley & Cuming, *supra* note 393 at 921 & 922.
[425] *Ibid.* at 922.
[426] See *ibid.*

computerization and related issues (making computer-based advantages available to ordinary users; training the registry's personnel to use computers and improving their remuneration; and constructing adequate and well equipped registry offices).

Although the Federal District and other cities in Mexico have already made available some electronic devices with the aim of helping to speed up its registration procedures; such devices are seldom used because they do not provide all the advantages that computer technology can offer.[428]

According to Colín Sánchez the problem is more complex than it may seem. There are numerous legal scholars who believe that computer-based procedures will free the Public Registry system from anarchy, bureaucracy, excessive paperwork, and immorality. Now is the time to replace human intervention with computers and other technologies. Technological equipment is very expensive, and while it could be justified in places where the volume of data being processed and stored is high, we should consider the Mexican government's scarce financial resources.[429] In this regard, Heywood Fleisig, an ex-Economic Advisor in the World Bank's Private Sector Development Department, implicitly suggests that governments in developing economies should, among other things, permit the privatization of registry services and allow private registry offices to compete with public ones.[430]

Furthermore, Colín Sánchez states that the Mexican community should also be conscious of its socioeconomic reality, which does not permit improvisations nor justify

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[427] See "Computerization of Registries", *supra* note 390 at 343.
[428] See Colín Sánchez, *supra* note 123 at 72.
[429] See *ibid.*
[430] See H. Fleisig, "Secured Transactions: The Power of Collateral" at 6, online: World Bank <http://www.worldbank.org/fandd/english/0696/articles/0150696.htm> (date accessed: 15 February 2000). H. Fleisig is now Director of Research at the Center for the Economic Analysis of Law, located in Washington.

innovation whose purpose is solely to innovate. This attitude will waste the nation's money. However, this does not mean that Mexicans should be against progress and technology, but that they should be aware that sometimes progress carries with it some negative effects. Those in favor of modernizing Mexico's registry system should realize that Mexico, a country with multiple deficiencies, ranks needs according to their economic potential and that problems are always confronted and solved according to their magnitude. The reason for such classification of needs is to respond to those people who argue that more important than technology is the Mexican people who have their own particular needs. Additionally, priority should be given to investing in human capital, which consequently, will create more employment and provide a just and adequate remuneration for jobs. Training of the registry office's personnel should be fostered because it is from their high efficacy that the good operation of these institutions and their overall level of proficiency depend.[431]

IX. Ranking of Rights

A. General Scheme of Priorities

The main purpose of security interests is to achieve preferential treatment for the secured creditor (lender) against competing claims of other secured and unsecured creditors of the debtor (borrower). Conflicts are likely to arise between creditors, and in Mexico notice of the lender's interest is the key to resolving these conflicts over property.[432]

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[431] See Colín Sánchez, *supra* note 123 at 72-73.

Contrary to Colín Sánchez's point of view, Castro Marroquín argues that the use of modern sophisticated technological devices will improve considerably the economy of a certain state or country. He states that all these modern machines used by the registries could well be paid for in a very short period of time if the Mexican government were to save money by cutting the number of registry offices and the amount spent on personnel wages. See Castro Marroquín, *supra* note 351 at 164-165.

[432] See Garro, *supra* note 7 at 236-237.

As has been explained before, notice can be achieved in two ways, depending on the possessory or non-possessory nature of the security interest. On the one hand, a possessory security interest is perfected and notice is given by taking actual possession of the collateral. On the other hand, a non-possessory security interest is perfected and notice is given by the registration of the interest in the Public Registry. Therefore, in possessory security interests the ranking of the lender's rights will depend on the time he took possession of the collateral, and his privileged rank shall be preserved so long as he retains possession. Thus, although a contract of pledge is concluded and the pledgee has plans to take possession of the collateral, a third party shall defeat the pledgee's interest in the collateral if he purchases the collateral before the pledgee has taken possession.[433] Similarly, if the pledgee takes possession of the collateral before the perfection of a competing non-possessory security interest by its registration, the pledgee's interest shall prevail. Among competing pledgees, priority is determined by the date of the contract of pledge or their date of registration.[434] However, "the fact that the pledgee has perfected his security interest by taking possession does not assure him priority over all subsequent creditors."[435] Some claims are granted a higher rank than the pledgee's security interest by virtue of statutory liens; for example, taxes owed by the pledgor,[436] wages of employees owed by the pledgor for the previous year,[437] expenses of foreclosure,[438] expenses for the upkeep of the collateral,[439] and rent owed to the lessor of the premises where the collateral is located.[440]

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[433] See *CCDF*, *supra* note 16, arts. 2871 & 2872.
[434] See *ibid.*, arts. 2982 & 2985(iv). These provisions refer to priorities among conflicting hypothec creditors; however, they may be applicable by analogy to priorities among conflicting pledgees. See Garro, *supra* note 7 at 237.
[435] *Ibid.*
[436] See *CCDF*, *supra* note 16, art. 2980.
[437] See *ibid.*, art. 2989.
[438] See *ibid.*, art. 2985.
[439] See *ibid;* see additionally *ibid.*, art. 2986.
[440] See *ibid.*, art. 2993(vii). See Garro, *supra* note 7 at 237.

When the debtor defaults, he is obliged to surrender his assets, except for those considered as unalienable or exempt from seizure by the Code of Civil Procedure.[441] Therefore, when the debtor defaults, conflicts of priority are likely to arise between the mass of creditors in bankruptcy or other insolvency proceedings.

There are two different types of insolvency proceedings in Mexico: (1) bankruptcy proceedings *(quiebra y suspensión de pagos)*, which are open only for merchants pursuant to the Bankruptcy Law (LQSP); and (2) general liquidation of assets *(concurso civil* or *concurrencia)*, which is open for non-merchants pursuant to the Civil Code. Insolvency proceedings for merchants under the Bankruptcy Law and for non-merchants under the Civil Code list different priorities. This difference is important for determining the ranking of the pledgee's rights. If the pledge is civil then the Civil Code shall apply; but if the pledge is commercial, then the Bankruptcy Law applies.[442]

1. Insolvency Proceedings Under the Civil Code

Under the Civil Code there are seven types of creditors whose interests rank as follows:

The first two types of creditors are those having a special privilege who are given a preferred rank for claims that may be satisfied only by certain goods of the debtor: (1) secured creditors, against specific items of collateral[443] (e.g., tax debts shall be paid with the value of the goods that gave rise to them, hypothecs and pledges shall be paid with the value of the goods that secure the credit, etc.); and (2) special lien creditors, such as crop lenders, landlords, carriers, and judgement lien holder's registered attachments against specific items.[444]

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[441] See *ibid*, art. 2964.
[442] See Garro, *supra* note 7 at 238.
[443] See *CCDF*, *supra* note 16, arts. 2980-2992.
[444] See *ibid.*, art. 2993.

The remaining types of creditors may be satisfied with the whole property of the debtor.[445] These creditors with a general privilege are divided into the following classes: (3) "first class" creditors who provide food, medical care, and administration of property to the debtor;[446] (4) "second class" creditors, composed principally of dependents or heirs, and unperfected security interests;[447] (5) "third class" creditors whose claims are embodied in a public deed or otherwise in any other authenticated document;[448] (6) "fourth class" creditors whose claims are embodied in a private document;[449] and (7) "fourth class" creditors whose claims originate from sources other than those of the preceding classes and whose claims shall be paid pro rata.[450] The claims of these creditors with a general privilege are subordinate to the claims of the latter creditors having a special privilege.[451]

As a result, except for the payment of taxes, wages, expenses incurred in the respective trial and in the sale of the collateral, and administrative or maintenance costs of the collateral, secured creditors (pledgee and hypothec creditor) with a perfected security interest enjoy the highest rank under the Civil Code.[452] Those secured creditors with perfected security interests need not participate in insolvency proceedings, being permitted to proceed directly to enforce their pledge and hypothec rights before the courts with the aim of getting paid with the value of the collateral.[453] However, if the contract of pledge or hypothec is embodied in a public deed, the creditor may intervene in the

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[445] See *ibid.*, arts. 2994-2998; see also *ibid.*, art. 2977 (where no priority may be established according to transactional chronology, claims are paid pro rata).
[446] See *ibid.*, art. 2994.
[447] See *ibid.*, art. 2995.
[448] See *ibid.*, art. 2996.
[449] See *ibid.*, art. 2997.
[450] See *ibid.*, art. 2998.
[451] See Garro, *supra* note 7 at 239.
[452] See *CCDF*, *supra* note 16, arts. 2980, 2981, 2985 & 2989.

insolvency proceedings and qualify as a "third class" creditor. This option may be preferable in some cases if we take into account that claims from "third class" creditors receive satisfaction from all the assets of the debtor, while creditors with a perfected security interest rely on the specific item subject to the security interest. Therefore, if the creditor chooses to proceed directly to enforce his rights and he faces a number of creditors competing for the same collateral, their claim will be paid pro rata; however, if he chooses to intervene in the insolvency proceedings as a "third class" creditor and there are few creditors in the intervening classes of creditors, all the other assets of the debtor are able to satisfy the debt.[454]

2. Insolvency Proceedings Under the Bankruptcy Law

Regarding the commercial pledge, when the debtor defaults and the creditor is to compete with any third parties for a portion of the debtor's assets, the rank of the creditor is determined by the priority rules under the Bankruptcy Law. "As against third parties in bankruptcy, the mercantile pledge does not do as well as the civil pledge."[455] The Bankruptcy Law establishes five preference classes under its ranking provisions: (1) particularly privileged creditors; (2) hypothec creditors; (3) special privilege creditors; (4) common creditors due to commercial operations; and (5) common creditors due to civil law.[456] Commercial pledgees are members of the third class.[457] Therefore, particularly privileged creditors, including employees with wage claims up to a year old and claimants of medical or funeral expenses, take precedence over all other claims and may invade the pledged collateral where other assets are insufficient to fulfill the debtor's

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[453] See *ibid.*, art. 2981.
[454] See Furnish, *supra* note 7at 37.03[2].
[455] Garro, *supra* note 7 at 240.

obligations.[458] Contrary to this, under the Civil Code, the value of the security interest held by the pledgee is not diminished in the same way. Moreover, the pledgee classified in third place is given rights inferior to those of the hypothec creditor. This is a significant difference from the ranking provisions under the Civil Code, where pledgees and hypothec creditors are equal members of the same preference class.[459]

"In order to obtain a more coherent set of priority rules, it is advisable to make those rules applicable to both merchants and non-merchants. .... The dichotomy ... between civil insolvency proceedings and bankruptcy does not conform to commercial realities."[460] Following such recommendation, Garro's Model Rules establish some "Rules of Priority in General". For example: (i) "a perfected right of security has priority over an unperfected right of security"; (ii) "priority between unperfected rights of security is determined by the order in which they are created"; (iii) "unless this law provides a special rule for priority determination, priority between perfected rights of security in the same collateral rank according to the date, hour, and minute of filing, or according to the time of delivery of the collateral, or according to the time of perfection, as the case may be"; (iv) and "if future advances are made while a right of security is perfected by filing or the taking of possession, the right of security ranks with respect to the future advances as it does with respect to the first advance".[461]

Moreover, there is an overabundance of statutory liens. The number and magnitude of preferential debts have so expanded that the largest portion of the debtor's

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[456] See *LQSP*, *supra* note 36, art. 261.
[457] See *ibid.*, art. 264.
[458] See *ibid.*, art. 262.
[459] Compare *CCDF*, *supra* note 16, art. 2981 with *LQSP*, *ibid.*, art. 265.
[460] Garro, *supra* note 7 at 241.
[461] "Reform and Harmonization", *supra* note 8 at 150 & 151 (arts. 106-109).

assets are mostly exhausted by the costs of insolvency proceedings,[462] the claims of the state for taxes,[463] and claims arising from wages, and medical and funeral expenses.[464] Many times, after these preferential claims have been paid, there is little left for secured and unsecured creditors.[465]

> This situation can only be regarded as most unfortunate, and it constitutes a considerable hazard to orthodox financing against consensual securities. A financier extending credit to a developer against security by, say hypothec or pledge, has little chance of ascertaining the existence or extent of preferential rights against the collateral, and no means of guaranteeing against future preferential rights, so that his valuation of the collateral may in the event of default turn out to be quite inaccurate and leave him virtually unsecured.[466]

Garro's Model Rules propose a single law in security interests for governing rights of security over movable property, corporeal and incorporeal, created by contract. Such law shall not apply to hypothecs (preference in payment in immovable property) nor to privileges, namely, statutory liens (preference in payment obtained by law).[467]

Moreover, the Rules provide:

> [T]he proceeds of the disposition of the collateral shall be applied consecutively to: (i) the reasonable expenses of seizing, repossessing, holding, repairing, preparing for disposition and disposing of the collateral; (ii) to the extent provided for in the agreement and not prohibited by law, the reasonable attorney's fees and legal expenses incurred by the secured obligee; (iii) the payment of the secured obligation secured by the right of security under which the disposition is made; and (iv) the payment of the secured obligation secured by any subordinate right of security in the collateral if written notification of demand therefor is received before distribution of proceeds is completed.[468]

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[462] See *CCDF*, *supra* note 16, art. 2985(i).
[463] See *ibid.*, art. 2980; see also *LQSP*, *supra* note 36, art. 261.
[464] See *LQSP*, *ibid.*, arts. 261 & 262.
[465] See "Reform and Harmonization", *supra* note 8 at 109.
[466] R.M. Goode, "A Credit Law for Europe?" (1974) 23 Int'l & Comp. L.Q. 227 at 266.
[467] See "Reform and Harmonization", *supra* note 8 at 126 (arts. 3 & 4).
[468] *Ibid.* at 147 & 148 (art. 95).

B. ACTUAL REGISTRATION VS. FILING FOR ESTABLISHING PRIORITY

A scheme of priority rules in any country is crucial for both lenders and borrowers in order to measure the legal consequences of security interests. In Mexico, priority can be acquired by creditors either by a contractual arrangement or by operation of law. The Civil Code allows the debtor to celebrate with his creditors any agreements he might consider necessary to agree on priorities. These agreements must be entered by a properly constituted meeting of creditors. However, any individual agreement between the debtor and any of his creditors is null and void.[469] The creditors' proposed agreement should be open to discussion and to a poll. In addition to the judge's approval of the agreement, in order to make the creditors' decision binding it is necessary that the number of creditors who voted be more than half of those attending the meeting and that their interest in the insolvency proceeding covers at least three-fifths of the indebtedness, subtracting the amounts of the credits of the hypothec and pledge creditors who chose not to participate in the insolvency proceeding; such agreement should not produce any effects upon them.[470] A period of 8 days following the date when the meeting took place and the agreement was approved is given to dissident creditors and those who did not attend the meeting to declare their opposition.[471] However, the only valid justifications that these creditors may allege in order to overturn the agreement are those based on the lack of meeting formalities, legal capacity of the voters, fraud among the debtor and creditors or among the creditors themselves, or because the requirements established by Article 2969 of the Civil Code were not met.[472] Regarding subordination of rights of

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[469] See *CCDF*, *supra* note 16, art. 2968.
[470] See *ibid.*, arts. 2969 & 2973.
[471] See *ibid.*, art. 2970.
[472] See *ibid.*, art. 2971.

security, Garro's Model Rules provide that "a secured obligee may, in a contract of security or otherwise, subordinate his right of security to any other right. A subordinate agreement is effective according to its terms between the parties and may be enforced by a third party for whose benefit the agreement was intended."[473]

Because the pledge was the recognized consensual security interest in personal property, the ranking provisions provided by the Mexican Civil Code are limited to correlate priority entitlements obtained by operation of law with priority obtained by a pledgee.[474] As non-possessory security interests began to be gradually recognized in Mexico, new ranking situations arose. The legislature responded by adding them to the ranking rules already existing for the pledge, failing to provide clear rules regarding any possible priority contests that could arise between the newly created non-possessory security interests, the pledge, and the various liens arising by operation of law. A new set of rules must be adopted by Mexico, where all ranking problems arising between consensual security interests and statutory liens are dealt with in a systematic manner. This set of rules may follow the approach taken by the drafters of Article 9, where priority rules are focused and limited to security interests created by agreement of the parties, excluding the priority of liens arising by operation of law.[475]

In Mexico, there are three important principles generally accepted in the basic scheme of priorities:

> (1) before a secured creditor has taken appropriate steps to give public notice of his security interest, his security interest should be subject to the rights of most third parties who acquire an interest in the collateral and had no means of discovering the existence of the prior interest; (2) by giving public notice of his security interest, a secured creditor should be

[473] "Reform and Harmonization", *supra* note 8 at 151 (art. 110).
[474] See *ibid.* at 79. See *CCDF*, *supra* note 16, arts. 2980-2998.
[475] See "Reform and Harmonization" *ibid*; see also *UCC*, *supra* note 6, s. 9-310.

> able to acquire priority over the rights of most third parties; and (3) as between two competing interests, the first in taking appropriate steps to publicize its security interest should prevail.[476]

This scheme of priorities was established under the Roman principle *prior in tempore, potior in iure (el que es primero en tiempo, es primero en derecho)*, which means "whoever is first in time, shall be first in right". This general principle contains two main ideas: (1) it seems to be fair that earlier claims should prevail over subsequent ones; and (2) it shows an assumption that subsequent creditors will be able to know who was first in time, thus giving them the opportunity to imagine whether a specific asset of the debtor is encumbered and whether there are any competing claims that might take priority over his. Article 9 also takes into account these two assumptions within its basic scheme of priorities; nevertheless, one major difference relating to the role actual registration plays as a key factor in the determination of priority contests between creditors exists.[477]

This difference is evident in cases where between two security interests that have both been perfected through registration, priority is given to the interest that was first perfected by actual registration of the security agreement in the Public Registry without regard to the date of its constitution.[478] Unlike the Mexican system, under Article 9 priority would be given not to the interest that was first perfected, but to the one that was perfected under an earlier filing, without regard to the respective times at which the security interests attached and the financing statement is actually registered.[479] Therefore, whereas under Article 9 the time of filing the financing statement is

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[476] *Ibid.* at 80.
[477] See *ibid.*
[478] See *CCDF*, *supra* note 16, art. 3013.
[479] See *UCC*, *supra* note 6, ss. 9-301, 9-306 - 9-312, where most of Article 9's priority rules are contained.

considered to be the relevant time for determining priorities, in Mexico's system security interests rank as of the time actual registration of the security agreement is done in the Public Registry.[480]

Consequently, we can say that public registration is a key factor in the perfection of non-possessory security interests for both Article 9 and the Mexican regime.[481] However, a major difference between these two systems is that Article 9 permits filing in advance to perfection, which has a different impact on the determination of priorities. As has been discussed before, this is not possible under a transactional registration system like the one used in Mexico. Therefore, while in Mexico the "first in time" creditor is the one who has first perfected his security interest through registration in the Public Registry, in the United States the "first in time" creditor is the one who files the financing statement first, even though this does not necessarily result in perfection.[482] Obviously, these different approaches between the two systems frequently result in different priority outcomes. This fact leads us to discuss some of the advantages of keying priorities to filing rather than to perfection.[483]

1. Advantages of Adopting Article 9's Filing Approach

In Mexico, the filing or tendering of the document for registration in the Public Registry is not enough for the secured party to perfect a non-possessory security interest; only after actual registration of the security agreement in the proper registry does the security interest become oppossable against third parties, perfected, and thus obtain

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[480] See "Reform and Harmonization", *supra* note 8 at 81.
[481] See *UCC*, *supra* note 6, s. 9-302(1)(a), which lists a possession-perfected security interest as an exception to the general requirement of filing.
[482] See *ibid.*, s. 9-303.
[483] See "Reform and Harmonization", *supra* note 8 at 82.

priority.[484] Mere filing of the security agreement only serves as a means for establishing preference between the diverse documents presented to the registry in order to ascertain their order of priority for their registration.[485] In contrast to this approach, under Article 9, a security interest may be perfected upon mere acceptance of a financing statement for filing by the proper registry officer. Thus, although a financing statement may not yet be registered, the security interest is deemed perfected by operation of law.[486]

The problem regarding the actual and correct registration approach for perfection of security interests followed in Mexico can be explained as follows: There is an evident gap between the time of presenting the security agreement at the registry and the time when the information contained therein is checked, corrected if necessary, indexed, and properly registered in the books to produce legal effects. In other words, there is a potential disparity between the date of registration and the date of validity. Where the creditor's security agreement is not registered as soon as it is presented, there is a risk that there may be another security interest affecting the same collateral that may prevail, either because the other second security agreement, although presented later, was registered first, or because the first security agreement was erroneously indexed and hence improperly registered. Although Mexican law provides several sanctions to be applied against registry officers and other registry personnel involved in the registration process where they may be found liable for any unjustified delays and errors caused in

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[484] See *CCDF*, *supra* note 16, arts. 3013 & 3007.
[485] See *ibid.*, art. 3015. See also *RRPPC-NL*, *supra* note 352, art. 25 (adding as requirement for the achievement of such preference the payment of fees for the use of the register).
[486] See *UCC*, *supra* note 6, s. 9-403(1).

the operation of the registry,[487] the enforceability of the security interest against third parties is nonetheless affected.[488]

On the other hand, Article 9, which stipulates that perfection of a security interest depends on the time of filing, could be the best model for Mexican legislators to follow in order to confront the aforementioned problems. The filer would be guaranteed the priority status he expects to have, not being dependant on the actual, prompt and correct registration and indexing of the security agreement.[489]

Quebec law follows a similar path to Article 9. For example, Article 2945 of the CCQ provides:

> Unless otherwise provided by law, rights rank according to the date, hour and minute entered on the memorial of presentation,[490] provided that the entries have been made in the proper registers. Where publication by delivery is authorized by law, rights rank according to the time at which the property or title is delivered to the creditor.

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[487] See *CCDF*, *supra* note 16, arts. 3003 & 3004; see also *RRPPC-NL*, *supra* note 352, arts. 69-72.

[488] See "Reform and Harmonization", *supra* note 8 at 83.

To clearly illustrate the disparity between the date of registration and the date of validity, and the problems these time gaps create, let's suppose that debtor Company "A" asks for a loan from creditor "BANCO". "A" pledges some machinery under a *refaccionario* pledge in favor of "BANCO". "BANCO" then presents the *refaccionario* pledge on 1 September 1999 at 8:00 a.m. All required parties appear before the registry officer, who ratifies the document and then stamps the contract with a chronologically-assigned number. The pledge contract then proceeds to the registry's evaluation department. The terms and provisions of the contract pass the qualification. Based on the average time it usually takes to qualify such documents (two days), the pledge contract would be registered on 3 September at 1:00 p.m. Once the pledge contract has been registered, the pledge will be effective against third parties from the date and time stamped on the contract when it was presented, in this case 1 September 1998, 8:00 a.m. A third party, Company "C", a retailer of used machinery, may be interested in purchasing all of "A"s machinery. Assume that "C" makes an inquiry at the registry on 2 September 1999 to determine whether there are any encumbrances on file covering "A"'s machinery. Considering that the pledge was not approved and registered until September 3, "C" will be inclined to rely on the fact that its inquiry, made the day before, did not show any encumbrances. Based on its findings, "C" will purchase "A"s machinery. However, as explained, "BANCO"s security interest in the machinery will be considered valid from the date of presentation, 1 September 1999, 8:00 a.m. Therefore, "C"'s rights to the pledged machinery will be subordinate to the prior interest even though "C" relied on what appeared to be an appropriate inquiry. See Wilson-Molina, *supra* note 11 at 19.

[489] See *ibid.*

[490] *CCQ*, *supra* note 141, art. 3012: "Applications are deemed presented from the time they are received by the registrar entrusted with the keeping of the proper register."

Similarly, Garro's Model Rules provide that a right of security must be perfected by filing in order to become effective against third parties, unless the law provides for automatic perfection or other means for giving public notice of that right. Perfection by filing takes place when a copy of the contract of security or a financing statement is presented to the proper registry office, and filing shall be complete upon acceptance for registration of the contract or financing statement.[491]

In addition, rather than using a manual registry system, where delays between filing and registration are likely to arise and affect priority entitlements, a computerized registry should be adopted to minimize this problem.[492] In order to close the gap between negotiation and search of the records and filing the secured transaction, pre-filing should be possible. Mexican legislators devised a mechanism to help creditors with their problem regarding the gap between negotiation and the searching of records in order to make the decision as to whether or not to proceed with a transaction. This mechanism, called preventive notice *(aviso preventivo)*, confers a certain priority status as of the time a security agreement is entered into the records, if the beneficiary of such notice files the deed for registration within the prescribed period of 30 days.[493] However, this preventive notice mechanism provides a limited time to prospective creditors during negotiations to make decision to lend. On the other hand, pre-filing has a significant advantage over the latter mechanism for obtaining pre-registration priority because the priority obtained from the time of filing does not expire after a limited period of time, giving the parties ample time for their negotiations.[494] However, a time limit must be stipulated by law in order for it not to affect the debtor's relationship with other potential creditors either for the same loan or a different one and in case the first negotiation does not crystallize; perhaps a period of 60 to 90 days would be reasonable.

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[491] See "Reform and Harmonization", *supra* note 8 at 132 (arts. 27, 28 & 29).
[492] See "Some Recent Canadian Developments", *supra* note 390 at 163.
[493] See *CCDF*, *supra* note 16, art. 3016.
[494] See "Reform and Harmonization", *supra* note 8 at 86.

CONCLUSION

Mexico's has an antiquated law for secured financing that serves as a legal barrier to trade and investment in the NAFTA region, thereby effectively preventing many lenders, investors, entrepreneurs and exporters from doing business with Mexico. It also hinders economic growth and democratic reform in Mexico. The deficiencies of the Mexican secured financing system limit the availability of commercial credit and restricts the success of ongoing Mexican business concerns and foreign interests. As a result, many U.S., Canadian and Mexican groups cannot avail themselves of the benefits that the NAFTA intends to provide.[495] This thesis has illustrated the current legal framework of security interests in personal property in Mexico, as set forth in the Civil Code for the Federal District and the various applicable Commercial laws. In view of the defects and inadequacies provided by Mexico's secured financing system, this thesis proposed some modern approaches that could be considered for adoption in Mexico to confront business practices and the weaknesses of the current system.

This thesis' research stemmed from the following four premises: (1) modern business depends on credit; (2) economic growth is somewhat dependent on the availability of secured credit; (3) an efficient economy needs an efficient commercial law; and (4) the need for law reform to facilitate secured credit transactions in Mexico has already surfaced and cannot wait.

The models used for guidance, based on the successful experiences of our NAFTA trade partners, the United States and Canada, were Article 9 of the Uniform

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[495] See National Law Center for Inter-American Free Trade Home Page, "Secured Financing Project" at 1, online: NLCFIT <http://www.natlaw.com/secfin.htm> (date accessed: 1 February 2000).

Commercial Code, Book Six of the Civil Code of Quebec and the Canadian Personal Property Security Acts.

The following shortcomings have been identified:

(i) antiquated and obsolete laws on secured financing;

(ii) unsuitable principles for the contemporary commercial lending marketplace; Mexican law allowed the complicated rules governing immovable (real estate) secured financing to control personal property secured transactions, making security interests generally confined to be possessory;

(iii) patchwork pattern of fragmented and overlapping rules scattered throughout the provisions of the civil and commercial laws;

(iv) multiple and uncoordinated security devices that have prevented an efficient secured financing system;

(v) difficult, expensive and uncertain procedures for the creation of security interests;

(vi) narrow group of people who can enter into secured transactions;

(vii) limited range of property subject to non-possessory security interests that has inhibited the Mexican system from meeting business needs, and where the after-acquired property feature is absent, thus making most accounts receivable and inventory financing commercially impractical;

(viii) rigid and unnecessarily specific collateral description requirements creating inflexibility;

(ix) slow and expensive judicial enforcement procedures (remedies) when a borrower defaults that encumber the system;

(x) absence of an efficient, computer sophisticated and inexpensive registry or filing system prevents effective publicity, unavailability of pre-filing; and

(xi) unclear and ineffective rules regarding perfection, public notice and priority to mediate conflicts between parties.[496]

Unlike its northern neighbours, Mexico has not adopted efficient far-reaching legislative changes in its personal property security law; therefore, while NAFTA technically opens Mexico's financial services sector to U.S. and Canadian lenders, the domestic legal system effectively prevents these lenders from doing business in Mexico.[497] However, the process of assessing and adopting some of the approaches followed by Article 9, the CCQ and the Canadian PPSAs will not be easy or quick.

The adoption of legislation based on UCC-type financing will be difficult project for Mexico; therefore, national and regional working groups should be created in order to carry out the challenging task. These working groups should be comprised of affected parties, including representative groups of borrowers, lenders and legal advisors. Key Mexican participants might include the National Association of Mexican Notaries, the Mexican Bankers Association, the Counsel to the Private Business Sector and representatives from the Public Registries of Property and Commerce. Key international participants may include the World Bank, the International Monetary Fund, the National Law Center for Inter-American Free Trade and the United Nations.[498] These groups

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[496] See T.C. Nelson, "Secured Financing Project" at 1, online:
NLCIFT <http://www.natlaw.com/pubs/sfproj.htm> (date accessed: 1 February 2000).
Todd C. Nelson is one of the members of the Secured Financing Project at the NLCIFT.
See also Fleisig, *supra* note 430 at 2 & 6.

[497] See Nelson *ibid.*

[498] Professor Ulrich Drobnig of the Max Planck Institute for Foreign and Private International Law completed a comprehensive report examining the major issues involved in modern personal property security law. In this report he states that most legal systems need to modernize the law on security interests in personal property and that UNCITRAL might provide assistance in meeting this need. Moreover, he

should assist the Mexican federal government by reviewing current substantive law and practice, recommending legal reforms and drafting substantive secured financing legislation and the law and regulations governing a modernized electronic commercial registry in Mexico. They should work closely with the Public Registry of Property and Commerce in Mexico to conduct research and analysis of the current state of the registry systems and to propose reforms in this area. For registry system reforms, working groups comprised of Canadian, Mexican and U.S. affected parties and experts could also be organized in order to provide substantive assistance to the Mexican Legislative Committee. Hopefully, these working groups can help alleviate Mexico's commercial credit problems, stimulate economic growth, contribute to political and economic stability, and significantly enhance Mexico's potential as a trading partner.[499]

After the modernization of Mexican Personal Property Security Law has been achieved, the secured financing laws and registry systems of the NAFTA countries should be harmonized.[500] Then, since the secured financing system in Mexico is similar to those systems followed in other countries of Latin America, perhaps the changes proposed in this study could serve as models for reform for them as well. If this is possible, it might be realistic to harmonize secured financing throughout the Americas, as

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states that: "While the use of security interests is an important means of financing commercial transactions, the law in most States is rudimentary and as such is not appropriate to respond to the needs of modern commerce." "Report of the Secretary-General: Study on Security Interests (A/CN.9/131)" (1977) 8 UNCITRAL Y.B. at 171-221.

See also "Report of the Secretary-General: Security Interests; Feasibility of Uniform Rules to be Used in the Financing of Trade (A/CN.9/165)" (1979) 10:2 UNCITRAL Y.B. at 83 [hereinafter "UNCITRAL 10"].

[499] See NLCIFT, *supra* note 495 at 1 & 2; see also Nelson, *supra* note 496 at 1 & 2.

[500] Harmonization will require not only changes in the respective countries' substantive law but also in their registration systems. Can you imagine an electronic network that would allow a bank in, say, Quebec, Canada to check, via a remote computer link, the Public Registry of Property and Commerce of Monterrey, Mexico prior to considering a loan to borrowers in those jurisdictions or with assets located there? See Kozolchyk, *supra* note 5 at 4.

is being tried in the area of international trade under the Free Trade Agreement of the Americas (FTAA). In the future, all systems should be harmonized so that they are functional and effective within a hemispheric framework.[501]

However, the first step towards modernization should be taken at the domestic level. The United States, including the civil law State of Louisiana, and Canada, including the civil law province of Quebec, have bravely dealt with this modern revolution on secured transactions. Therefore, what then is Mexico waiting for if it wants to keep pace with its North American neighbors in the coming years?[502]

See also R.C.C. Cuming, "Harmonization of the Secured Financing Laws of the NAFTA Partners" (1995) 39 St. Louis U.L.J. at 809 ff. [hereinafter "Secured Financing Harmonization"].

[501] See NLCIFT, *supra* note 495 at 1 & 2.

See also L. Pereznieto Castro, "La Uniformidad Y Armonización De Los Sistemas De Garantías Comerciales Y Financieras" (1998) Revista Mexicana de Derecho Internacional Privado at 21-34.

[502] "Mexico must recognize that many companies now feel the need for security mechanisms on personal property; .... This need is specially important since under the NAFTA, Mexican manufacturers, wholesales and retailers are now competing with U.S. and Canadian firms which do avail themselves of the asset maneuverability and cheaper credit that Article 9 of the U.C.C. and the Canadian Personal Property Security Act provide". See Wilson-Molina, *supra* note 11 at 22.

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