TITLE FINANCING DEVICES AND THE UNITARY MODEL OF SECURED TRANSACTIONS WITHIN THE FRAMEWORK OF THE HUNGARIAN CIVIL CODE

By

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Abstract

In the present Thesis I primarily focus on the unitary model enshrined in UCC Article 9, since it is proved to be a very successful approach within the framework of personal property security law. Secondarily, I address the issue of the title financing devices with respect to their dogmatic place within the framework of personal property security transactions. After the elaboration of the unitary concept and the short introduction of its specific features of the United States secured transaction law, I will analyze the Hungarian academic debate related to the title financing devices. Finally, through the intrusive example of the financial leasing, I will justify that the recently adopted Hungarian Civil Code satisfies both the recommendations of the UNCITRAL Legislative Guide and the basic idea of the unitary concept with respect to the title financing devices. The conclusion of the Thesis is that despite the aversion vis-à-vis the unitary model in Europe, the fundamental idea of the unitary model should not be bypassed if a country is determined to develop a well-functioning secured credit system.

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Introduction

i. The importance of (secured) credit

Credit is one of the main catalysts of the market economies' development. It is a well-known fact that "the more developed a country's security is, the higher is the demand for credit and consequently also for adequate security devices."[1] At a micro-level, the borrowers' general aim is to receive credit at the lowest cost possible. As the UNCITRAL Legislative Guide on Secured Transactions (hereinafter: Guide) simply puts it, the easiest way of facilitating cheap credit leads through the enhancement of an effective and comprehensive secured transaction regime. In other words, it means that the legislature should enable the parties to create security rights the easiest and fastest way possible.[2] The main consideration behind secured credit is to reduce the creditor's risk in case of the debtor's default or insolvency, thereby empower the creditor's willingness to give or extend the credit. Moreover, the increased likelihood of the creditor's recovery fosters predictability irrespective of the debtor's uncertain future performance.[3]

However, where there is credit, there must be debt as well. The existence of debt is not a bad thing, a stigma in itself, but an indispensable token of a vital market economy.[4] Yet, in Central and Eastern Europe – partly due to old reflexes stemming from the former socialist planned economy – there is a traditional aversion to debt in general.[5] Therefore, the development of the region's

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[1] Drobnig, Böger, *Proprietary Security in Movable Assets* (Selier European Law Publishers GmbH, Munich, 2015) Introduction, A, para 1. 205.

[2] UNCITRAL Legislative Guide on Secured Transactions (UNCITRAL Guide), para 49., 51. <http://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf> accessed 26 March 2015.

[3] ibid 2. para 5-6.

[4] See Linda J Rusch and Stephen L Sepinuck, *Problems and Materials on Secure Transactions* (St. Paul, Thomson/West, 2006) 1.

[5] Tibor Tajti, *Comparative Secured Transactions Law* (Akadémiai Kiadó, Budapest, 2002) 143.

credit economy is relatively slow compared to other countries such as the USA or the UK. Nevertheless, these highly developed credit economies showed that it is worth investing in the reform of secured transaction law, since it has fundamental effect on credit economies.

ii. The issue of title financing

While dealing with personal property security law, every legislature encounter with the issue of title financing transactions. Title financing devices denote agreements which aim at securing a loan by transferring or retaining the ownership right (title). Though title financing can take a variety of forms, what they have in common is that it is the title *per se* which secures the underlying transaction and functions as a security right. The legislators' role in this respect is manifold. They have to decide whether to regulate them primarily as secured transactions or as distinct and *sui generis* legal devices whose security purpose is just one feature among many others. Since in everyday life ownership can be easily transferred by contracts, title financing devices are based on the logic of contract law and they are traditionally regulated outside the scope of the otherwise complex and burdensome system of secured transactions. Thus, one may be tempted to say that title financing transactions offer a simpler and more effective way to achieve functionally the same economic outcome as secured transactions. Then the obvious question arises, whether title financing transactions are nothing else then shammed contracts, trying to bypass, *inter alia*, the stricter criteria of creation, registration, prescribed for secured transactions. Are they really shammed contracts, and if so, should the law prohibit such devices? Or should the legislator integrate them into a unified secured transaction system? Moreover, legislators should bear in mind their country's legal tradition and must not forget that (almost) every legal system's main priority is the economic efficiency – in the present case is to enhance credit availability.

iii. The justification of the Thesis

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The legislative situation is not as simple as it seems at first sight. The legislature may decide to completely abolish the title financing devices unique status and subject them to the same rules as secured transactions. Or, it may sustain their separation and leave to the parties to choose whatever device suits them the best. Naturally, any other alternative between these two extremes is conceivable as well. Thus, the Thesis revolves around the relation between the title financing transactions and the personal property security law based on the UNCITRAL Legislative Guide on Secured Transactions, the Uniform Commercial Code (hereinafter: UCC) and the newly adopted Hungarian Civil Code. The need for an adequate regulation is not negligible, and since Hungary – within the Civil Code – reformed its secured transaction system in 2013, it seems appropriate to examine how the Hungarian legislature has responded to the challenges with regard to title financing transactions. In order to obtain the required perspective for the analysis, the Thesis compares some peculiar features of the Hungarian regulation with that of a very successful secured transaction law (UCC) and a model law adopted by the UNCITRAL and elaborated by highly distinctive legal scholars from all around the globe.

Furthermore, the Thesis analyses whether or not the unitary-comprehensive model of the secured transactions is worth to follow, and if so, to what extent the recent Hungarian secured transaction reform adopted this model.

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iv. The Thesis' terminology

The terminology of secured transactions law has given rise to many misunderstanding in the course of reform efforts in Hungary.[6] The misunderstandings and imprecisions mainly emanate from the

[6] Tibor Tajti, 'Viehweg's Topics, Article 9 UCC, the 'kautelarische Sicherheiten' and the Hungarian Secured Transactions Law Reform' (2002) SSRN Electronic Journal <http://www.researchgate.net/publication/228224543_Viehweg%27s_Topics_Article_9_UCC_the_%27

fundamental differences between the common law and the civil legal tradition. In order to overcome such difficulties and with respect to the comparative nature of the Thesis, I have deliberately chosen the terminology set forth in the UNCITRAL Legislative Guide on Secured Transactions for the following reasons. The Guide has been adopted by a supranational organization mainly dealing with international trade law under the auspices of the United Nations. The international status shields the UNCITRAL from biases in favor of any major legal systems, therefore – at least in theory – it offers impartiality to their propositions. Hence, "[t]he terms used are not drawn from any particular legal system. Even when a term appears to be the same as that found in a particular national law (whether secured transactions or any other law), the Guide does not intend to adopt the meaning of the term in that national law."[7]

However, besides the terminology of the Guide as a general point of reference, there are fundamental terms need to be clarified. Though some of them will be defined in the course of the argumentation, a few general terms need to be clarified immediately. *Personal property security transactions* consist of all the transaction that aim at securing a claim, therefore both the secured transactions and title financing transaction are part this broadest category. In the Thesis the term *secured transaction* denotes all kinds of transactions that create security right in personal property. *Title financing transactions*, on the other hand, consist of devices aim at using the title for security purposes.[8] Therefore whether or not title financing devices fall within the scope of secured transactions, may differ jurisdiction by jurisdiction. In the United States title financing is deemed to be a secured transaction owing to its security purpose, while in Hungary they do not create

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kautelarische_Sicherheiten%27_and_the_Hungarian_Secured_Transactions_Law_Reform> accessed 26 March 2015, 97.

[7] Guide (n 2) 4-5. para15.

[8] Thus leasing in UCC Article 2 does not qualify as a title financing device in the present Thesis.

security rights, hence do not qualify as such. In the Thesis, unless otherwise indicated, I will use title financing as distinct from secured transactions.

Though the Hungarian legal system does not treat personal and real property as collateral differently in a structural level (i.e., the Civil Code's secured transaction provisions cover both of them), UCC article 9 deals solely with personal property and fixtures (this latter category is unknown in Hungary). Broadly speaking, personal property is everything what real property is not,[9] while fixtures are tangibles that are inseparables from the land to which they are attached.[10] Since the detailed analysis of different types of collateral is not the objective of the Thesis, for the sake of simplicity the term *collateral* will refer to personal property as both tangible and intangible assets and as the antithesis of real property.

v. Roadmap to the Thesis

The following comparative analysis is divided into three major parts. In the first chapter, I will introduce the idea of the unitary model. The first part analyzes the UNCITRAL Legislative Guide on Secured Transaction and briefly the Draft Common Frame of Reference (hereinafter: DCFR). Thereunder, I will outline the main concepts with regard to different legislative approaches and briefly comment each solution's theoretical background. The second part deals with the approach of the United States, namely with Article 9 of the Uniform Commercial Code, which will be considered as a highly effective and practical unitary model for secured transactions.

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[9] Tajti (n 5) 55.
[10] ibid 56.

In the second chapter I devote a detailed and very intrusive analysis to the Hungarian title financing devices in order to present the pre-Code academic discussion related to this field of law and to address the difficulties the legislator might face if did not apply the functional approach of the unitary model. The second chapter might be conceived as the antithesis of chapter one. While the first chapter presents the structured and foreseeable credit-life *with* the unitary model, the second addresses the theoretical basics of an unpredictable credit-life *without* the unitary model.

In the third chapter I will pay special attention to financial leasing for numerous reasons. Firstly, it is a very successful and popular type of title-related transaction in the United States and in Hungary and has huge influence on the development of credit economy in general.[11] Secondly, the transaction is defined somewhat similarly in both jurisdictions, however, their structural regulation is completely different. Thirdly, financial leasing bears the characteristics of both secured and sales transactions, therefore this "hybrid" device seems very useful to analyze the security purpose of title financing devices.

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[11] In 1987 more than $310 billion were the outstanding lease receivables in the United States according to the Department of Commerce. John M. Stockton, Fredereick H. Miller, Sales, Sales and Leases of Goods (3rd edn, West Publishing, 1992) 238.

Chapter 1: The Unitary Model

1.1. The UNCITRAL Legislative Guide on Secured Transactions

The UNCITRAL Legislative Guide on Secured Transactions generally aims at promoting economies accessibility to credit and offers a modern and plausible secured transaction model law in particular.[12] It was adopted in 2007 by the United Nation's General Assembly, published in 2010, and arguably one of the most ambitious efforts of creating a common and harmonized reference for all the states who intend to improve their secured transaction law.[13] For our purpose the Guide seems extremely useful, since it expressly states that it "seeks to rise above differences among legal regimes to offer pragmatic and proven solutions that can be accepted and implemented in States with divergent legal traditions."[14] Therefore, unlike the security system enshrined in the UCC, it has no national roots and cannot be accused of being tainted by some moss-clad legal tradition or by other local politico-economic interests. The other reason the Thesis regards the Guide as a good starting-point is that it admittedly employs the fruits and considerations of other previous model laws and conventions[15], among others the EBRD Model Law on Secured Transactions the Core Principles for a secured transactions law[16], the Uniform Act Organizing Securities of the Organization for the Harmonization of Business Law in Africa,[17] and the OAS's (Organization of American States) Model Inter-American Law on Secured Transactions[18]. Moreover, the Guide strongly takes into consideration the relation between secured transaction and insolvency law. In

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[12] Guide (n 2) 1. para 1.
[13] Drobnig (n 1) 206.
[14] Guide (n 2) 1.. para 2.
[15] ibid para 3. 12.
[16] Model Law on Secured Transactions, published by the European Bank for Reconstruction and Development (London, 1994), <www.ebrd.com/country/sector/law/st/core/model/core.htm> accessed 26 March 2015.
[17] Uniform Act Organizing Securities of the Organization for the Harmonization of Business Law in Africa <www.ohada.com/textes.php?categorie=458> accessed 26 March 2015.
[18]Model Inter-American Law on Secured Transactions http://www.oas.org/dil/uniform%20law%20review.pdf accessed 26 March 2015.

order to do so the UNCITRAL also enacted its Insolvency Guide[19] similar to the Guide at hand.[20] Furthermore, the Guide stresses that in order to establish or implement an effective and fully functioning secured transaction system, each pursuit should bear in mind "the relationship between secured transactions law and the general law of obligations, property law, civil procedure law and insolvency law."[21]

The scope of the Guide embraces traditional security devices (pledge, non-possessory security right, right of retention of possession, etc.), security rights in intangible assets (e.g. intellectual property rights, receivables) and most importantly, title financing transactions (retention of title and transfer of title for security purposes).

In conclusion, as the Guide itself says, its underlying aim is to "achieve practical economic benefits"[22] by adopting modern and well-founded secured transaction laws by respecting and taking into account other efforts that have been already set forth in this field of law.

1.1.1. The main objectives and policies of the Guide

In the following I will concentrate upon those objectives that bear relevance on title financing transactions, since the Guide treat them within the category of secured transactions. Among the objectives related to the secured transaction system in general, we can find two of key importance regarding the Thesis' analysis. The first objective is "to provide for equal treatment of diverse

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[19] UNCITRAL Legislative Guide on Insolvency Law, Chapter XII, <http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf> accessed 26 March 2015.
[20] Guide (n 2) 1-2. para 1, 6
[21] ibid 26. para73
[22] ibid 1. para 3

sources of credit and of diverse forms of secured transaction".[23] With respect to the personal property security law – either they take the form of lease, retention of ownership or secured transaction – equal treatment is crucial, since it creates high competition among different creditors and will enhance the competition between them. The second important objective might be labeled as enforcement efficiency maxim,[24] which emphasizes that the appropriate regulation of a security right or e.g. a retention-of-title right for security purposes does not end with, among others, detailed elaboration on priority, third party, registration issues, but one of its neuralgic point is that how a formally flawless personal property security transactions can be enforced in case of the debtor's default or insolvency.

Apart from the aforementioned general "policy objectives" the Guide delivers a long and exhaustive list of objectives that should be pursued by States aiming at facilitating well-functioning and effective secured transaction law. For the purposes of the Thesis, I particularly underline two crucial ones: (i) "To promote low-cost credit by enhancing the availability of secured credit"[25], (ii) (ii) "To balance the interests of all persons affected by a secured transaction"[26]

1.1.2. Title financing devices in the Guide

With regard to the economic function of title financing devices, it is clearly similar to secured transactions. For instance in case of retention-of-title, the aim of the seller-creditor is to retain ownership, therefore, to get preference over other creditors with respect to the sold (leased) asset. Thus, the asset economically functions as collateral and the retained title as security right. This high level of economic similarity encouraged states (e.g. the United Kingdom) to treat the title financing

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[23] ibid 20. para 52
[24] Guide (n 2) 21. para 56
[25] ibid Recomendation 1.
[26] ibid

transactions as quasi-security.[27] The question which follows their unique status is obvious: whether to handle these quasi-security rights within the coverage of secured transactions or to subject them to unique rules, which are probably materially different than that of the secured transaction law.

According to the Guide, the legislature has at least four options: 1.) to give full effect to the unique character of title financing devices and regulate them separately from secured transactions, 2.) the same as option 1., but with the caveat that the retention of title may secure the purchase price at maximum (i.e., not the proceeds or any other credit unrelated to the collateral), 3.) to treat title financing as a separate type of transaction, but functionally harmonize it with the secured transaction system, or 4.) to put them under the coverage of a unitary secured transaction regulation (unitary-model).[28]

Though at first sight they all seem equally adequate options, they do not have the same economic and structural benefits. As we will see in detail in the second part of the Thesis, the lack of an appropriate regulation may lead to the legal system's significant dysfunctions. First, I will analyze the unitary model (option 4) according to the Guide and the UCC Article 9, then in Chapter 2, in the example of the Hungarian system I will address the problematic features of the first two options. Option 3 will be addressed at the end of the Thesis as the currently pursued model of the Hungarian personal property security law.

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27 ibid 54. para 98; See Roy M. Goode, Legal Problems of Credit and Security (Sweet & Mawwell 2nd ed. 1988) 2-3; Tajti (n 5) 93
28 Guide (n 2) 55. para 100

1.1.3. The Guide's unitary model

The unitary idea, inaugurated by the UCC, had great effect not only in the US, but in New Zealand, India, Canada, recently in Australia[29] and even upon conventions and model laws, such as the EBRDL Model Law or the OAS Inter-American Model law on Secured Transactions.[30] This unprecedented popularity underlines its practical value and positive effects on market economies.

Accordingly, the Guide adopts and advocates the unitary model, the totally "functional, integrated and comprehensive approach to secured transactions."[31] The "totally" adjective is not a coincidence, since it is conceivable that though title financing devices will be under the scope of secured transactions for security purposes (i.e., the same creation, priority, third party and filing rules apply to them as to secured transaction), other branches of law, like taxation or accounting will still treat them as separate devices. In the following, I will refer to this latter legislative approach as "semi-unitary model."[32] Irrespective whether a legislature chooses a unitary or a semi-unitary model, the decisive factor must be its functional approach, i.e., the approach to recognize that both secured and title financing transactions have the same economic function.

> The law should adopt a functional approach, under which it covers all rights in movable assets that are created by agreement and secure the payment or other performance of an obligation, regardless of the form of the transaction or the terminology used by the parties (including rights of transferees under a transfer of title to tangible assets for security purposes, rights of an assignee under an assignment of receivables for security purposes, as well as rights of sellers or financial lessors under various forms of retention-of-title agreement and financial leases, respectively).[33]

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[29] Australian Personal Property Security Act 2009 (entered into force in 2012)
[30] Guide (n 2) 56. para 103
[31] Guide (n 2) 57. para 110 and Recommendation 8.
[32] ibid 337. para 79,
[33] ibid 62. Recommendation 8, first sentence

Simply it means that the differences between title financing devices and "traditional" secured transaction devices are abolished and they will be subject to the same set of rules.[34] A great advantage of this system is its cost-efficiency, that is to say, the creditor does not have to evaluate the possible credit devices one by one, thereby saving important time and resources.[35] Moreover, for the purpose of facilitating secured credit, it enhances competition among creditors by applying equal legal treatment to creditors. Finally – and maybe less importantly – the unitary model is easier to apply.[36] However, the Guide itself admit that the unitary system may have some disadvantages as well. First, it limits the freedom of contract, since it alters the transaction irrespective of the parties' intent. Second, since in several states secured transactions deemed to be an exception from the general framework of credit transactions, this approach may subvert the domestic balance by widely exceeding the boundaries of secured credit transactions.[37] Third, at first glance it turns against the *numerus clausus* of proprietary rights due to the (theoretically) unlimited types of transactions to which it can be applied. However, it must be promptly noted that this latter obstacle is illusory and will be discussed in detail in Section 2.1.7.

1.1.4. The second-level of the unitary model: acquisition financing

The Guide defines acquisition financing in the following way: "Whenever an enterprise or consumer acquires tangible assets on credit, and rights in the acquired assets are to serve as security for credit, the transaction is a form of secured transaction that the Guide calls an 'acquisition financing transaction'."[38] The definition contains the following important elements: (i) the transaction aims at acquiring *tangible* assets on credit, (ii) acquisition financing is within the scope of secured transactions, therefore (iii) both security rights and title financing devices may be subject

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34 ibid 58. para 110,
35 ibid 56-57. para 106
36 Guide (n 2) para 65, 334.
37 ibid 57. para 108
38 ibid 319. para 3

to acquisition financing and (iv) the "acquisition security rights"[39] or title financing rights are related to the acquired asset, which thus serves as collateral. Furthermore, albeit acquisition financing can be conceived both on secured and unsecured basis, the Thesis shall primarily address the former option. In order to secure the acquisition financing transaction, the parties may recourse to formally different, but functionally similar devices, such as retention-of-title, consignment,[40] lease, security right, and notably, the obligation of repayment can be assured by operation of law (e.g. "vendor's privilege"[41]).

The Guide is based on a two-step legislative approach. Whilst it advocates a fully unitary model at the level of secured transactions in general, it adopts a slightly different approach in respect of acquisition financing. The rationale behind this approach is that the secured party in case of acquisition financing is not merely a lender, but usually a seller as well. Thus the Guide leaves open the question whether the states would apply the logic of sales or the logic of secured transactions to acquisition financing transactions.[42]

Hence at the second level, the Guide recommends only a functionally integrated approach with regard to acquisition financing. Within this approach, states may choose between the unitary and the non-unitary model. Naturally the non-unitary model is admissible solely in case of "seller-like" transactions, such as financial lease, retention-of-title, etc.[43] Thus, if a legislature chooses this model it will apply different rules to "seller-like" (i.e., title financing) transactions for the purposes of acquisition financing than to secured transactions for the same purpose. However, the Guide's

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[39] ibid 154. para 22
[40] ibid 323-324. para 25
[41] ibid 327. para 36
[42] ibid 334. para 66
[43] ibid 338. para 80

functional approach applies here as well, since states should give functionally equivalent outcomes both to a secured transactions and a title financing transaction. On the other hand, the unitary approach – preferred by the Guide – means that the rules of secured transactions, save the priority rules,[44] apply to all kind transactions.[45] Therefore a seller who retains title for security purposes and thus finance the acquisition of the asset, shall be deemed not as owner, but secured creditor who owns nothing but the security right attached to the asset. Section 1.2.5. will tackle the unitary model of acquisition financing under the pretext of purchase-money security interest.

The reason why the Guide (and the Draft Common Frame of Reference) applies a two-level regulation method and thus treats acquisition financing separately from secured transactions in general is twofold. First, it is a "broad international agreement that acquisition financing deserves special, favorable treatment because of its general benefit for economic development."[46] Briefly, the increase of purchasing power enhances the economy. Second, the commercial practice historically tended to favor sellers of tangible assets and vested them with high priority rights (usually by the manipulation of the title) to the detriment of the secured and unsecured creditors.[47] Thus different title financing practices developed in national levels on the basis of pure sales law.[48]

Under the pretext of acquisition finance, the Guide addresses another very important issue, namely the three-pronged relationship between the lender (financer), the seller and the buyer. As mentioned above, the gist of acquisition financing regulations is the consideration that the one who enables the acquisition of a tangible asset, obtains super-priority position over other secured

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[44] And probably some other details, for instance the exact filing requirements.
[45] Guide (n 2) 337. para 78
[46] Drobnig (n 1) 242.
[47] See the history of conditional sale in the United States in Section 1.2.6
[48] See Section 2.2.

creditors. However, in many countries the lender, who solely advances money to a buyer in order to acquire the selected goods, does not have this super-priority status, but only simple secured creditor status at the best. In other words, in some countries the whole idea of acquisition financing is confined to the seller-buyer relationship, excluding the financial lender from the legal benefit (i.e., the super-priority) of the transaction.[49] To overcome this obstacle, lenders often purchased seller's priority status, or in case of leasing, the lender simply bought the leasing contract as a whole from the lessor. However, these solutions may not be sufficiently effective, since the lender may not intend to be an owner, or just simply wants to avoid the burdensome technicalities and high transaction costs.[50]

1.1.5. Draft Common Frame of Reference

The Draft Common Frame of Reference (hereinafter: DCFR) is based on the fact that so far there is no regulation of the European Union or any binding European convention concerning the law of secured transactions. In the Thesis the DCFR's short introduction is justified, since contrary to the fact that it is intended to be a new European civil code and elaborated by leading European scholars from EU Member States, its Book IX. is based on the unitary model of personal property security law.[51]

However, despite the aforementioned inclusion of the unitary model, with regard to title financing devices, the DCFR adopts a more conservative approach than the Guide. It applies only a quasi-unitary model. In other words, title financing devices are subject to the rules of secured

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[49] Guide 328. para 40

[50] ibid 328. para 41

[51] Tibor Tajti, 'Could Continental Europe Adopt a Uniform Commercial Code Article 9-Type Secured Transactions System? The Effects of the Differing Legal Platforms' (2014) Adelaide Law Review, 150.

transactions[52], save, *inter alia*, specific issues of transferability, effectiveness vis-à-vis third parties, priority, termination and pre-default rules.[53] This approach can be traced immediately at the first section of Book IX., whereas it instantly makes the distinction between security rights and "ownership retained under retention of ownership devices",[54] provided that both of them fall within the scope of the law. This distinction implies that the DCFR does not inaugurate the same "totally" unitary model set forth in the Guide. The DCFR does not treat title financing devices uniformly either since the transfer of ownership for security purposes on a personal property is considered as a security right, thus it follows the concept of unitary approach, [55] while in case of retention-of-ownership a different regime applies.

Similarly to the Guide, the DCFR has a second regulatory level, i.e., the level of acquisition financing. Retention-of-ownership for security purposes is automatically deemed to be acquisition financing,[56] while in case of secured transactions, the secured creditor still needs to meet some obligations, that is to say the secured creditor has to be the seller of the collateral or the lender of the price of the collateral. Additionally, secured transactions and title financing devices qualify as acquisition financing device only if they are registered within 35 days after the purchase of the asset. Otherwise they are ineffective and lose their superior position.[57] Thus, similar to the Guide, the DCFR recognize that acquisition financing can be achieved by both secured transactions and title financing devices (retention-of-title devices). However, though the DCFR insists on the implementation of the functionary approach,[58] it deliberately casts the unitary model out of the

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[52] the DCFR uses the name of "proprietary security in movable assets"
[53] Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference, Outline Edition, (DCFR), Article IX. 1:104
[54] ibid Article IX. 1:101 (1)
[55] ibid Article IX. 1:102 (3)
[56] DCFR (n 53) Art IX. 1:102 (3)(a)
[57] ibid Art. IX. 3:107 (1)-(2)
[58] It denotes the same thing as in the Guide.

scope of acquisition financing, since some of the states' bankruptcy and/or insolvency law do not recognize the super-priority of acquisition financing security rights.[59]

The acquisition financing regulation achieves its goal through the provisions about super-priority. Accordingly, retention-of-title devices automatically and secured transactions conditionally enjoy preferential status over other secured creditors. However, if someone else than the security provider (usually the buyer) has already created a security right on the asset before the actual sale, that previously created right shall have priority over the acquisition financier's super-priority.[60]

1.2. Unitary model in the Uniform Commercial Code

1.2.1. Introduction to UCC Article 9

The Uniform Commercial Code elaborated by the National Conference of Commissioners on Uniform State Laws and the American Law Institute shortly after World War II is only a model law in the abstract, providing a recommendation for States to enact their own statutes on commercial law. Before the UCC, States had had their own diverse commercial state law, primarily based on precedents, however its adoption changed this diversification. Nevertheless, the UCC is not merely a tool of harmonization, but a highly practical legal statute, and its adoption is justified not only by the legal uniformity but by its practicality in the everyday commercial life for all kinds of business entities.[61] Today, each state has enacted the UCC (even Luisiana, with the exception of Article 2 and 6)[62], thereby harmonizing commercial law throughout the United States.

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[59] Drobnig (n 1) 243.
[60] ibid 567-568.; DCFR (n 53) Art IX. – 4:102.
[61] Tajti (n 5) 120.
[62] Sepinuck (n 4) 43.

1.2.2. Building blocks of Article 9

The UCC comprises nine articles, each dealing with different aspects of commercial law. Article 9 is concerned with personal property security law and it has been under revision three times so far (last in 2010). Though not explicitly stated in the statute, several building blocks could be inferred from the text, such as "(1) the unitary and comprehensive concept of security interests; (2) the system of priorities; (3) the floating lien concept; (4) the filing system, and (5) the enforcement system."[63] Without the building blocks the whole idea of the unitary model would be only a vague abstraction. Therefore I will shortly demonstrate how the building blocks complete and closely correlate with the unitary model. In the following section I will shortly introduce the unitary model,[64] the filing system, the priorities system and enforcement, but only to the extent necessary for comparing the UCC's title financing approach to the new Hungarian personal property security law.

1.2.3. The UCC's unitary model

Since Section 1.1.3 discussed the basic idea of the unitary model, here I will address only some of its less theoretical features worth to consider through the example of a very much alive and highly practical legal system such as the US.

A fundamental feature of the pre-UCC personal property security law was its variegation. Security interest could have been created by chattel mortgage, trust receipt, consignment, field warehousing, and so forth. Moreover, not only their name differed, but they also fell under different regimes, for instance the filing requirements, parties' rights and obligations, or other formal requirements differed in substantial ways.[65] This complexity provided a great deal of uncertainty whilst the

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63 Tajti (n 5) 141.
64 Though the unitary model is the cohesive force of Article 9, it is a building block as well.
65 Tajti (n 5) 127.

business needed calm and foreseeable circumstances for smooth operation. In response to this challenge, Article 9 promulgated a comprehensive set of rules, also known as the unitary system. The basic idea is the same as we had already seen below: it means that all kinds of transactions creating security interest in a collateral, irrespective of its form or the title's actual holder, is deemed to be a secured transactions and thus exclusively regulated by the rules of Article 9.

Though the scope of Article 9 is extended to other transactions as well (e.g. consignment and agricultural lien), the majority of secured transactions falls within the scope of paragraph (1), whose central term is the "security interest". Since this term is practically unknown in continental Europe, it should be further explained. The difference between "security interest" and "security right" bears importance especially because the UNCITRAL Guide on Secured Transactions has chosen to use "security right" (instead of "security interest") as a common unifying concept. Though "interest" has a slightly broader meaning than that of right, it can be construed as "a set of rights in the collateral security law."[66]

1.2.5. Filing

The filing system is closely interrelated to the unitary model since both of them stem from the UCC's same functional-practical approach and both of them harmonize the hitherto fragmented personal property security law. In civil law terms I would say that filing is registration of the attached security right at a national authority by submitting a financial statement issued by the secured creditor. It functions as a public notice, and it is the main defense against the threat of ostensible ownership, since it is "an effective method of giving a debtor's creditor's notice of encumbrances on his property"[67]. Moreover, it is important that the US filing system is not

[66] Tajti (n 5) 53.
[67] Grant Gilmore, *Security Interest in Personal Property* (Little, Brown and Co., Boston, 1965, reprinted in 1999), 463.

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transaction filing, but notice filing. It means that the latter does not inform about the "actual state of affairs",[68] but indicate solely the parties to the transaction and not the transaction (or the collateral) *per se*.[69] Whereas before the enactment of the Code numerous filing systems applied even in one State, the unification of filing requirements – just like the unitary model – made the field of law more simple and cost-efficient.

Filing is the most commonly used way of perfecting a security interest. Though the filing system does not cover every transactions in the US (e.g., filing based on federal statutes) it is the most unified public notice system in the world.[70] It is worth to note that with regard to the recent Hungarian security reform, it was an issue that who should be entrusted with the maintenance of the registry system, or, in other words where should be the place of filing? Finally, the chattel registry reform, given the task to the public notaries.[71] In contrast, the UCC does not specifically designate the exact authorities, but leaves this competence with the states[72] and makes only recommendations.[73] The rationale behind this legislative decision was the incompatible interest of different industries (finance companies, consumer-advocates).[74]

1.2.5. The purchase-money security interest

Purchase-money security interest (hereinafter: PMSI) can be created "to the property acquired by the debtor by virtue of the purchase-money loan."[75] Thus, the PMSI is basically the US counterpart of acquisition financing. With reference to the structural framework of the UNCITRAL Guide it

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[68] ibid 469.
[69] Transaction filing became very cumbersome due to the appearance of inventory financing and account receivables financing. Tajti, (n 5) 146.
[70] ibid 145.
[71] Hungarian Collateral Registry Act 2013 ("2013. évi CCXXI. törvény a hitelbiztosítéki nyilvántartásról") 2. §
[72] Gilmore (n 67) 517-518.
[73] UCC § 9-401 (2002)
[74] Gilmore (n 67) 517
[75] ibid. 783.

can be said that the UCC has a double-level regulatory system with regard to acquisition financing as well. Though it is not expressly stated in the Code, the second level of the US acquisition financing regulation adopts the unitary approach, hence basically the same rules apply to PMSIs as to secured transactions. However, due to its heavy economic weight, the regulation differs in certain ways,[76] most importantly with respect to priority issues.

1.2.6. Conditional Sale – the predecessor of the PMSI

In the United States the recognition of the conditional sale by the courts was quite doubtful in the 19th century.[77] The gist of the problem was that in case of sale without retention of title, after the buyer got possession over the goods, even if the buyer did not pay, the seller could sue only for the unpaid balance, but cannot repossess the goods. The career of conditional sale began as courts started to recognize the distinction between *sale on condition* and *sale absolute*. The former, whereby the seller could have retained the title if the buyer had broken the condition (i.e., to pay the purchase price), was the predecessor of the modern conditional sale. [78] Since in the case of the conditional sale it was the ownership which was retained, and not a security interest attached, it was not at all comparable to "traditional" security devices (chattel mortgage at that time). Moreover, it was generally held that conditional sales enable a much stronger seller position than personal property security rights.[79] However, the conditional sale was confined to cases where the collateral was owned by the lender and not by the borrower. Therefore, transfer of title by buyer for security purposes was traditionally deemed as ineffective, and it was nothing more than granting security interest (chattel mortgage) by the buyer on the property.[80] An important issue regarding the history of conditional sale is that though a financial lender could not resort to conditional sale, since he

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[76] Additionally, it should be noted that filing is not required for the creation of PMSI in consumer goods. UCC § 9-302(1)(d) (2002)
[77] Gilmore (n 67) 62.
[78] ibid 66.
[79] ibid 67.
[80] ibid 68., 69.

had not title to the property, a few US courts recognized the financial lender's pseudo-title as a title good enough for the purposes of conditional sale.[81] This court practice may be perceived as the predecessor of the modern PMSI, whereby the legislator does not differentiate between the seller and the mere financial lender. If the acquisition financing purpose is realized both of them are granted with the same priority position.[82]

It is important to emphasize the close relationship between the PMSI and the conditional sale, since the latter was the predecessor of the PMSI. The long lasting development of the PMSI – at least according to Grant Gilmore – started with the New Orleans Railroad case[83] where the railroad company executed a mortgage to all its future acquired assets ("general mortgage"). During the execution it turned out that the United States – a bondholder in the company – sold two locomotives and ten cars to the company in the form of a rolling stock. In return for the goods (i.e., indirectly for the purchase money) the company issued bonds thereby creating a lien on the property in favor of the United States. The issue before the Supreme Court was whether the general bondholders have priority over the government's purchase money claims despite that the latter was created after the general mortgage. As Mr. Justice Bradley pointed out, "A mortgage intended to cover after-acquired property can only attach itself to such property in the condition in which it comes into the mortgagor's hand. If that property is already subject to mortgages or other liens, the general mortgage does not displace them, though they may be junior to it in point of time."[84] In conclusion, the Supreme Court held that the United States' purchase money bond has priority, irrespective of the other bondholders' floating lien type general mortgage. Albeit at that time the

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[81] See Tri-County Finance, Inc. v. Miller, 267 Wis. 174, 65 N.W.2d 39 (1954) (cited in Gilmore [n 67) 69.
[82] See Section 1.2.7 in the Thesis.
[83] United States v. New Orleans R.R., 79 U.S. (12 Wall.) 362, 364-365, 20 L. Ed. 434, 436 (1871)
[84] ibid

PMSI was related only to rolling stock, the jurisprudence slowly expanded the scope of the PMSI collaterals to fixtures and other goods as well.

At the time of the New Orleans Railroad Case, conditional sale (i.e., reservation of title) was used as a vehicle creating a "condition in which it [the property] comes into the mortgagor's hand."[85] In case of conditional sale the asset came into the buyer's hand without the title. We can find here the common roots of the conditional sale and the PMSI, a title financing device and a secured transaction. It is apparent that the two devices' functions are the same. On one hand they secure a claim and on the other hand they finance buyer's acquisition by facilitating credit. The historical transformation from one to another underlines that they are functionally the same devices, solely the form and names differed. It can be conceived as another justification in support of the unitary model.

1.2.7. PMSI in the modern era

The PMSI's significance can be measured in light of the priority system. The main rule of priority is the "first in time first in rights" general rule. That is to say the secured creditor who created sooner its security interest than others has preference over other secured creditors with respect to the priority-order, i.e., he may satisfy his claims form the collateral before other creditors. However, the general rule does not allow the legislature to draw special attention to, and thus prefer, different groups of creditors. The main reason behind the PMSI's inauguration is the floating lien concept, whereby a creditor may attach security interest to all existing and after-acquired property. [86] Thus, without the super-priority it would be impossible to become a first-priority creditor, owing to the floating lien's full coverage. Lenders did not intend to give or extend credit for a debtor, whose existing and even the future assets were encumbered by the floating lien. Therefore it was obvious

85 ibid
86 UCC § 9-204. (2002)

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that future lenders have to find protection against the floating lien with regard to the after-acquired collateral.[87]

Hence, the UCC inaugurated the super-priority position for purchase-money secured creditors "over a conflicting security interest"[88]. However, the PMSI does not have negative effects on credit availability in general: the acquisition of further goods, encumbered with the PMSI, enhances the total value of the debtor's estate, therefore the PMSI is beneficial to other secured creditors (e.g., long-term financiers[89], usually financial institutions and banks) having floating lien attached to the after-acquired property.[90]

The collateral's type – which can be inventory, livestock, software or other goods – is very important in case of the PMSI. As a consequence, different perfection rules apply to different types of collaterals. While the perfection method in "normal" goods is relatively simple, in case of inventory, the secured creditor should perfect his interest at least until the debtor receives possession and sends a notification to conflicting secured creditors, in which he describes the inventory which is supposed to serve as a collateral. But what is the UCC's reason behind this peculiar regulation? In case of the sector-specific inventory financing if a new lender comes into the picture he must send notification to the debtor's formal lender, because due to the frequent inventory-transactions it is not reasonable to expect that the former lender knows about the new PMSI lender. "That would be very cumbersome"[91] to ascertain before every transactions whether or not a new lender obtained PMSI in the purchased inventory.

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87 Ann. E. Conaway Stilson, 'The "Overloaded" PMSI In Bankruptcy: A Problem In Search Of Resolution' (1987) vol. 60. no. 1. Temple Law Quarterly, 14.
88 UCC § 9-324(a) (2002)
89 Tajti (n 5) 169.
90 Tajti (n 5) 167
91 Sepinuck (n 4) 336-337.

1.2.8. Enforcement of the security interest

In order to make a comparison with the Hungarian financial leasing in Section 3.2.2, in the following I introduce only the scenario when the secured party is not in possession of the goods and enforces his claim against a tangible collateral.

There is no definition of the "default" in the UCC, therefore the parties have to agree on a contractual default clause in their security agreement.[92] Unless there is an acceleration clause in the contract, the creditor may claim solely the missed installment and not the entire balance.[93] First, upon default the secured creditor could repossess the collateral. If the debtor does not comply with the repossession, the creditor may turn to judicial process or try to repossess it by his own means without the breach of peace.[94] The latter, called self-help repossession, "is a fundamental principle encouraged in common law systems and the Unitary Model, the opposite is true for civil law systems."[95] The judicial process, on the other hand, is fully recognized in continental Europe and usually it is the only mean to repossess the collateral. In the US the judicial process comprises diverse legal tools: it can be, among others, a replevin or an *ex parte* writ of sequestration[96]. Finally, after repossession, the creditor disposes of the collateral either through public or private distribution (usually sale, lease or license).[97] In case of consumer goods the creditor should send an explanation note to the debtor, which states how the creditor calculated the surplus or deficiency after the distribution of the proceeds.[98]

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[92] Chesapeake Investment Services, Inc. v. Olive Group Corp., 2003 WL 369682 (Mass. Super. 2003) (Not reported in N.E.2d) (in the parties' agreement a list of default events were listed, however, since Plaintiff could not prove that defendant fulfilled one of the "Event of Defaults", his motion was dismissed)
[93] Sepinuck (n 4), 137.
[94] UCC § 9-609. (2002)
[95] Tajti (n 53) 160
[96] See Mitchell v. W. T. Gran Co., 416 U.S. 600, 94 S.Ct. 1895, 40 L.Ed.2d 406 (1974) (reproduced in Tibor Tajti, *Comparative Secured Transactions* (Central European University, Budapest, 2014) 179.
[97] UCC § 9-610. (2002); Sepinuck (n 4) 156.
[98] UCC § 9-616. (2002)

Chapter 2: Title financing devices in the Hungarian Civil Code of 1959

This part of the Thesis aims at introducing the legal situation in Hungary with respect to the title financing devices before the entry into force of the new Civil Code on March 15, 2014. The following analysis is very instructive since the Hungarian legislature neither inaugurated the unitary model nor distinctively regulated the title financing devices at that time. Hence the legal practice had to deal with a situation when solely the general contractual principles of the Civil Code of 1959 applied to title financing transactions. Even the functional approach[99] was missing in the Code, which gave place to serious structural discrepancies. I will present some of these discrepancies below.

2.1. Title financing in Hungary

2.1.1 The theoretical background of the title financing devices

Provided that Hungary is a civil law jurisdiction it approaches the title financing devices from a structural-dogmatic point of view (as opposed to the practical common law approach). Therefore it is indispensable to briefly elucidate the common nature of title financing transactions. The category of title financing and fiduciary security overlap ("fiduciárius hitelbiztosíték"). However, since the term of fiduciary security frequently used in the Hungarian legal literature, in the following I will use this word interchangeably with title financing.

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[99] The statutory recognition that the title financing devices and secured transactions have the same economic functions.

The term fiduciary comes from the ancient Roman legal construction of *fiducia cum creditore contracta*, whereby a creditor promised that he would return the collateral to the debtor if certain conditions are met. Though the fiduciary transaction was perfected via *manciaptio* – an abstract transaction form, i.e., without *causa*, which was designed to transfer ownership by a solemn judicial act – and was regarded by the Roman jurists as a security device due to its security function.[100] However, in time, it was displaced by the *pignus* and *hypotheca* which can be regarded as the ancient prototypes of the modern security devices.

In modern Hungarian legal terminology "fiduciary", in the context of fiduciary security agreements, denotes that the owner (usually the creditor) is entitled to exploit the totality of his ownership rights only if certain conditions subsequent, stipulated in the contract, are met. Until that moment the owner-creditor must preserve and maintain the asset, account with the expenses and benefits and return the asset after the satisfaction of the underlying loan agreement by the debtor.[101] Therefore, fiduciary security arrangements have a double nature: on one hand the creditor is entitled to exploit the totality of ownership rights with regard to third parties (*in rem* effect), which we can call external relationship. On the other hand, since the creditor is bound by an agreement concluded with the debtor, his ownership rights are restricted with regard to the inner relationship (*in personam* effect).[102] In other words, the creditor must act by virtue of the fiduciary security agreement vis-à-vis his debtor. Thus, this Janus-faced agreement allows the creditor to validly encumber, sell, or otherwise dispose of the asset with regard to third parties, however, these action will be invalid with regard to the debtor if the fiduciary agreement provides so.

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[100] András Földi, Hamza Gábor, *A Római jog története és institúciói* (Nemzeti Tankönyvkiadó, Budapest, 2007) 320., 442.
[101] Péter Gárdos 'A biztosítéki célú tulajdon-átruházásról' ("On the Transfer of Ownership for Security Purposes") (1998) vol. 6. Gazdaság és jog, 18-21, 19.
[102] ibid 25..

2.1.2 The academic debate over the fiduciary devices

Before the entry into force of the new Hungarian Civil Code in 2014, a great debate was in progress whether or not the title financing transactions should have been regarded as valid contracts and whether or not the courts (or the new Civil Code) should have recognized these atypical, innominate contract forms. In order to better understand the underlying legal and policy considerations, I briefly introduce the main features of the debate.

In practice we differentiate between two historical systems of ownership-transfer: consensual- and traditio-based systems.[103] Since the Hungarian legal system (together with the German) is a traditio-based one, in order to transfer ownership by a contract two transactions are required (albeit they are usually embedded in one agreement): (i) the contract *per se* and (ii) the in rem transaction, i.e., the conveyance of the asset (*traditio*).[104] The conveyance is a legal act*,*[105] whereby the whole transaction is perfected and gains its *in rem* effect. It is important that the act does not have to be physical, such as the delivery of the asset, since the parties can stipulate that they convey the possession without actual delivery of the asset (*constitutum possessorium*).[106] Thus, the agreement of the parties plays a crucial role not solely in the contractual part of the transaction, but also in the part of the conveyance as well. Albeit, since the *constitutum possessorium* blurs the differences between the aforementioned two transfer-systems, from a practical point of view I tend to say that the historical background is almost the only reason jurists still differentiate them.[107]

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[103] In case of consensual ownership-transfer, the there is no separation of the contract and the conveyance. It is the situation e.g. in France and in the common law systems. Attila Menyhárd, *Dologi jog* ("Rights in rem"), (ELTE Eötvös Kiadó, Budapest, 2010) 224

[104] ibid 224-225; István Gárdos, Péter Gárdos, 'Van-e a fiduciárius biztosítékoknak helyük a magyar jogban?' ("Do Fiduciary Securities have Raison D'être in the Hungarian Law?") <http://ptk2013.hu/polgari-jogi-kodifikacio/gardos-istvan-gardos-peter-van-e-a-fiduciarius-biztositekoknak-helyuk-a-magyar-jogban-pjk-20041-2-33-47-o/360> accessed 26 March 2015

[105] Menyhárd (n 103) 237.

[106] ibid 229.

[107] ibid 230.

Based on the aforementioned, a valid contract must satisfy two requirements: it needs to have first a valid contractual *causa* (embedded in the contract) and second at least the intention of both parties concerning the conveyance of the asset. The causa is usually conceived as the economic purpose of the contract. In Hungary, being a traditio-based *causal* legal system, a valid causa is required for every contract. If the contract's causa is invalid, the conveyance becomes invalid too, and the transfer of ownership does not happen.[108] Due to the freedom of contract, in case of title financing devices the parties are free to choose the causa of the contract, since it is an atypical agreement. Accordingly, the Hungarian Supreme Court expressly recognized that the parties might choose any agreement they intend to enter into, in order to transfer the ownership.[109] "The title-aspect [*casua*] of the transfer of title does not mean more than there must be a contractual commitment which aims at transferring the title."[110]

As the Ministerial Report to the draft law concerning the Hungarian Civil Code[111] concludes, albeit the title financing devices apparently have served their task well in the practice, most of them are theoretically failed constructions, since they gave place to undesirable legal uncertainty.[112] Thus, with respect to this uncertainty, for instance the following question arose: what is the real causa of the fiduciary contracts? As elaborated above, under Hungarian civil law, in order to acquire ownership, there must be a valid title (causa). Though the Civil Code of 1959 did not provide the *causa fiduciae* expressly as a valid title, it did not mean that it cannot be deemed as valid causa, since the Civil Code did not give exhaustive list of titles.[113] However, in most cases the causa is not the

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108 Id. 241.
109 [1966] 17 Legf. Bír. Pfv. II. 21. 543, BH 1997. 436.
110 Gárdos (n 104) (translation by Gábor Kökényesi)
111 Ministerial Report to the draft law concerning the Hungarian Civil Code <http://www.parlament.hu/irom39/07971/07971.pdf> accessed 26 March 2015
112 Gárdos (n 104)
113 Zsolt Layer, László Leszkoven, 'A bizalmi (fiduciárius) biztosítékokról' ("On the fiduciary securities") (2004) vol. 1-2. Polgári jogi kodifikáció, 26.

transfer of title, but the securitization of a claim. Thus, the causa did not mark properly the effect (title-transfer) of the contract. The owner was not a "real" owner, its ownership was only temporarily restricted and he could not participate in the market. Moreover, if we had admitted the *fiducia* as a valid causa, the causa's function (i.e., it informs the public about the aim and nature of the transaction) would have become abstract and superfluous, because it would not have informed third parties about the parties' inner (*real*) legal relationship and about the true nature of the transaction.[114]

As opposed to this very abstract and unnecessarily complex civilian construction of title-transfer, the common low legal system advocates a much more practical approach. Usually it is determined based on the title that who bears the risk of loss, who should pay the taxes and so forth. Albeit many legal rules are attached to the title, "[t]he title concept is an abstraction not necessarily adaptable to commercial situations."[115] This opinion is well illustrated by the UCC's Official Comment to Article 2 and UCC

§ 2-401:

> The arrangement of the present article is in terms of contract for sale and the various steps of its performance. The legal consequences are stated as following directly from the contract and action taken under it without resorting to the idea of when property or title passed or was to pass as being the determining factor. The purpose is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of words and actions of a tangible character.[116]
>
> Each provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title.[117]

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[114] Gárdos (n 104)
[115] Stockton (n 11) 151.
[116] Official Comment to UCC § 2-101, cited in Stockton (n 11) 151.
[117] Section 2-401.

The following subparagraphs of § 2-401 provides various rules with respect to the time of the passage of title, except the parties otherwise agreed. The "residual jurisdiction"[118] of this section is clearly enshrined in the following case. The transaction between two US corporations for the transfer of two yachts did not contain any express provisions related to the transfer or title. In the case at hand the issue was when the title passes for tax purposes on the basis of the sales contract. The Court held that § 2-401 applies only if parties did not "otherwise explicitly agreed." Therefore the title passed upon the parties' intent. In this case upon the receipt of the Marine Bill of Sale.[119]

Furthermore, continental legal systems endorse the *numerus clausus* principle of proprietary rights, which means that new in rem right cannot be created, parties can turn only to those proprietary rights which are already set forth by the legislature. Though the parties might have transferred or retained the ownership *per se* and they did not create a new in rem right in a formal sense, as I have already emphasized, this "manipulated" ownership has a special nature: it is restricted by the *fiducia,* that is to say, by the provisions of the fiduciary agreement. Hence, in a material sense, the transfer of title for security purposes creates a new, so far unknown in rem right: formally the title belongs to the owner, but the asset could not be used in the market (sometimes it remains under the debtor's economic supervision). This is one of those structural dysfunctions that can be cured by the unitary model. Since the unitary model prescribes mandatory conditions (e.g. attachment rules) for a transaction in order to qualify as a secured transaction, despite the common belief, it does not allow all kinds of devices to create proprietary security rights. In other words its mandatory filter functions as a sort of "*numerus clausus*" with respect to new in rem security rights.[120] Consequently,

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[118] Stockton (n 11) 151.
[119] New England Yacht Sales, Inc. v. Commissioner of Revenue Services at 509.(1986) (cited in Stockton (n 11) 151.)
[120] Tajti (n 51) 166

under the unitary-model the fiduciary security agreements would qualify as secured transactions, therefore new in rem rights would not be created.

2.2. Title financing devices before 2014

The basic forms of fiduciary security devices under the Hungarian law were the following: (i) retention-of-title ("tulajdonjog-fenntartás"), (ii) sale contract combined with repurchase right ("visszavásárlási joggal kombinált adásvételi szerződés") and (iii) creation of purchase right ("vételi jog alapítása") on a certain asset. Later, the need of the financial market called into life other devices with fiduciary elements, such as (iv) financial leasing, (v) factoring and other (vi) repo transactions.[121] It is important to note that the retention-of-title, financial leasing, factoring and other repo transactions are still exist within the Hungarian legal system. Below, I would like to shortly introduce some of these devices [(i)-(iii)] with special attention to their fiduciary nature.

2.2.1 Retention-of-title122

By virtue of this device, the seller-creditor retains the ownership of the asset until the last instalment of the purchase price is paid by the buyer-debtor. At the moment of full payment, the ownership should be transferred upon the buyer-debtor.[123] The renowned civil jurist Gyula Eörsi put it this way: "at the period of transfer, the asset is still in the seller's sphere of interest, which is proportionately decreasing by the increasing payment of the purchase price"[124]

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[121] Id. The term "repo", as it is the shorthand for 'sale and repurchase agreement', basically means two transactions handled as one: the sale of securities providing their repurchase in a later time. Report of the Hungarian National Bank <http://www.mnb.hu/Root/Dokumentumtar/MNB/Kiadvanyok/mnbhu_mnbtanulmanyok/mnbhu_muhelytanulmanyok/mnbhu_muh_17/1-fej_hu.pdf> accessed 26 March 2015.
[122] Hungarian Civil Code 2013, § 6:216
[123] Hungarian Civil Code 2013, § 6:216 (1)
[124] Gyula Eörsi, *A tulajdonátszállás kérdéséről* ("On the Question of the Ownership-Transfer") (Légrády testvérek, Budapest, 1947) 31. (Transaction by Gábor Kökényesi)

As it was pointed out above, the underlying theory behind the retention-of-title is the divided nature of the transaction: dogmatically it consists of the contract itself and the transfer of ownership. Accordingly, the parties agree to transfer possession and at the same time, they stipulate the condition of full payment, whereby seller-creditor is entitled to retain the ownership until thereof. The transaction's second part is pending, and until its perfection, the seller-creditor remains owner of the asset, however the buyer-debtor is not deprived of everything, he has possession and the right of entitlement ("várományi jog").

In practice, retention-of-title reaches its unique goal if debtor becomes insolvent or bankrupt. In this case, based on his title of ownership, creditor may enforce his claim before other creditors either by ownership claim ("tulajdoni igény") or enforcement claim. ("végrehajtási igényper").[125] Both the Civil Code of 1959[126] and the new Civil Code contains specific provisions with regard to retention-of-titlle, and even the Supreme Court recognized that in case of retention-of-title, the asset does not belong to the estate of the bankrupt debtor.[127]

The characteristic fiduciary feature of inner (in personam) and external (in rem) legal relationship can be recognized here as well. As regards the creditor—debtor relationship, if the debtor is in default, creditor has the right to avoid the contract with retroactive effect, repossess the asset, while paying back the instalments already paid by the debtor.[128] As regards the external relationship against other creditors, seller-creditor has a very strong position, since he can claim as owner the asset from the debtor's estate, furthermore, other wrongful parties cannot acquire the asset from

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125 Menyhárd (n 103) 398.
126 Hungarian Civil Code 1959, § 368.
127 [2000] Legf. Bír. Fpk. VIII. 31.596; BH 2003.293.; Menyhárd (n 103) 399.
128 Hungarian Civil Code 2013, § 6:140. (1)

the debtor (however, other bona fide purchasers can).[129] In conclusion, creditor has significant in personam and in rem rights toward the debtor to enforce his interest.

The Civil Code of 1959 did not provide for an official public register, thus there was the danger that the asset's true owner remains hidden from the public (ostensible ownership). By recognizing that the lack of adequate regulation compromises the predictability of the market security, the legislature made the registration obligatory as of the entry into force of the new Civil Code: "In case of retention-of-title relating to personal property, the seller shall have it registered in the collateral register showing the fact of retention-of-title and the name of the buyer (…)"[130] This provision coincide with the general pattern of registration in the Civil Code, whenever the potential danger of ostensible ownership exists.

2.2.2 Sales contract combined with repurchase right ("SCCRR")

The essence of the SCCRR was that the debtor-seller sold the asset to the creditor-buyer, while stipulating his right to repurchase it. Therefore, at the time of the debt's full repayment, debtor was entitled to repurchase the transferred asset. If the debtor had failed to do so, the creditor would have obtained the ownership permanently.[131] As we have seen through the example of retention-of-title, due to his title of ownership, the creditor-seller's position would have been exceptionally strong in this case as well.

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[129] Orsolya Szeibert, 'A tulajdonjog-fenntartás mint hitelbiztosíték' ("The Retention-Of-Title as Security") (2000) vol 4. Polgári Jogi Kodifikáció, 11.
[130] Hungarian Civil Code 1014, § 6:216 (4) (Translation by Gábor Kökényesi)
[131] Menyhárd (n 103) 397.

The practical question that gave rise to the popularity of the SCCRR is the following: can we substitute the existing personal security devices with a more efficient one?[132] According to the Hungarian Bankruptcy Act,[133] the cost of liquidation has priority over any claim secured by a security right, when the debtor is not an individual. However, even if the debtor is an individual, the alimony and the employee fees have priority position vis-à-vis other security rights.[134] In response to this situation, before the enactment of the new Civil Code, several creditors insisted upon the use of SCCRR for the purpose of securing the transaction.

In the era before the new Civil Code, it was an acute question whether this atypical contract had been a proper one or a sham contract, since in the latter case it would have been null and void. If it had been shammed, the sales contract would have shammed the underlying loan agreement, i.e., the real intention of the parties. However, some argue that the contract was not not shammed, because the contract had a double-purpose: the creditor-seller's purpose was not solely the recovery of the lent money, but alternatively, the recovery of the ownership on the asset permanently.[135] It would have meant that nothing was shammed and the parties had two equally valid and understandable intention by the same contract: to secure the transaction on one hand, and to transfer the title in case of default on the other. Others argued that it was indeed a shammed contract, since by circumventing the pre-established security devices, it shammed the transaction's true economic nature and aimed at providing far better position to the creditor than under any security right. Furthermore, the rival theory did not provide clear answer, *inter alia*, to the question who bears the risk in case of the asset's destruction, not attributable to any party. If the contract

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132 Gárdos Péter, 'A biztosétéki célú tulajdon-átruházásról' ("On the Transfer of Ownership for Security Pursposes") <http://www.gfmt.hu/cikkek/a-biztositeki-celu-tulajdon-atruhazasrol.php> accessed 26 March 2015

133 Bankruptcy Proceedings and Liquidation Proceedings Act 1991

134 Gábor Zoltán Szabó, 'A visszavásárlási joggal kombinált adásvételi szerződésről' ("On the Sales Contract Combined with Repurchase Right") (1998) vol. 3. Gazdaság és Jog, 13.; Hungarian Law Enforcement Act 1994, § 165. § § 170.

135 Zoltán Szabó (n 135) 14.

had been deemed to be a loan agreement, creditor should have given a substitute collateral or pay the full amount immediately. If it had been a sales contract, the creditor would have lost the asset and, similarly, the debtor would have lost his right to repurchase it – both of them lose.[136] Anyway, the issue was not without consequences. Should the court had found that it was a shammed contract, two possibilities have remained: either the shammed contract would have been invalid, therefore the whole contract would have been null and void, or the shammed contract would have been valid and the rules relating to it would have applied.[137]

In conclusion we can say that the SCCRR offered a plausible alternative as a security device. The advantages were the following: (i) easy and fast creation, (ii) while the security right was only a limited personal property security right, the SCCRR offered in rem rights vis-à-vis third parties without limitation, and (iii) in case of debtor's bankruptcy, creditor's claim was already satisfied.[138] On the other hand, SCCRR hindered the Hungarian evolution of personal property security devices towards the secured transactions. Accordingly, as its disadvantages we can enumerate the following elements:[139] (i) the creditor's position – due to his title of ownership – became excessively strong and its counterpart, the in personam obligation vis-à-vis the debtor could not fully balance it, (ii) it was not likely that the creditor was willing to exercise, and especially to undertake all the risks (e.g. the risk of loss) and obligations arising out of the newly acquired ownership. (iii) Furthermore, without proper public register, the danger of ostensible ownership would have seriously threatened the third party interests.

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136 Gárdos (n 133)
137 Hungarian Civil Code 1959, §§ 207(4), 200(2), 242.
138 Gárdos (n 104)
139 ibid

2.2.3 Purchase option for security purposes

The new Civil Code defines the purchase option: "If the owner establishes the right to purchase a specific asset under the contract, the holder of such an option shall be entitled to buy the asset with a unilateral statement, at the price fixed in the contract."[140] The device gained its security purpose when the parties agreed that the creditor would have been entitled to buy the "collateral" if the debtor had failed to repay the loan.

Since parties did not intend to pay the transfer tax two times (as well as in the case of the SCCRR), the device was especially frequently used with regard to real property security purposes. When the debtor brought an action to avoid the contract, the court usually examined two aspects: whether it was a shammed contract, and whether it intended to circumvent the mandatory provisions of *lex commissoria* of secured transactions.[141] However, the Supreme Court finally stated, that these were – naturally with some extreme exceptions – valid contracts.[142]

2.2.4 Changes introduced by the new Civil Code

The new Civil Code – with some exception – expressly prohibits the use of the fiduciary securities. The very important provision goes as follows:

> *Any clause on the transfer of ownership, other right or claim for the purpose of security of a pecuniary claim, or on the right to purchase, with the exception of the collateral arrangements provided for in the directive on financial collateral arrangements, shall be null and void.*[143]

The field of personal property security law is very much influenced by the practice and accordingly in the past fifteen years title financing devices were used more and more often to circumvent the

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140 Hungarian Civil Code 2013, § 6:225 (1) (Translation by Gábor Kökényesi)
141 Gárdos (n 104)
142 BDT 2002/12/188.
143 Hungarian Civil Code 2013, § 6:99

secured transactions. For instance by stipulating a purchase right in the contract in case of the debtor's default, the creditor could have gained disproportionate pecuniary advantages, since he could have purchased the "collateral" for a striking disparity value (usually the value of the loan).[144] The courts gave three different responses upon the aforementioned problem:[145] (i) fiduciary securities are null and void, because the parties are intended to circumvent the Civil Code, which provides that "the secured creditor shall settle all account with the obligor and surrender any proceeds exceeding the amount the amount of the claim".[146] (ii) These contracts are null and void, because they are "manifestly in contradiction to good morals."[147] It is so because they allow the creditor's excessive enrichment. (iii) They are *not* null and void but could be avoided due to the apparent discrepancy between the collateral's value and the loan given by the creditor.[148] However, "during the codification of the Civil Code, the Supreme Court always took the view that the problem of fiduciary securities should be solved by the law, either by forbidding such devices, or, by providing appropriate legal guarantees".[149] Even from the above example it is clear that the Hungarian legislature faced a pressing problem and solution needed to be found as soon as possible.

Before the enactment of the new Civil Code, there were attempts to preserve the full scale of fiduciary securities. One solution would have been to follow the example of the financial leasing. The case-law provided that for instance the risk during the term of financial leasing shifts to the lessee, even though the general rule is that it is the owner who bears the risk of loss.[150] Moreover, it is interesting that first, the *Expert Proposal for the New Civil Code* would have settled the problem –

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144 András Kisfaludi, *Az új Ptk. magyarázata V/VI.* ("Commentary to the new Civil Code") (György Wellmann ed HVG-ORAC Lap- és Könyvkiadó Kft., Budapest, 2013.) 151.
145 ibid 151-152.
146 Hungarian Civil Code 1959, § 258 (3)
147 ibid § 200 (2)
148 ibid § 1959, § 236 (2) c)
149 Kisfaludi (n 145) 152.
150 BH 1998.496.

similar to the UCC – by a functional approach: all the contracts (with purchase right, repurchase right, transfer or title) that are concluded for security purposes are deemed to be security liens.[151]

Though several adverse effects of the fiduciary securities were enumerated above, the legislative's official reason behind the abolition of the fiduciary collateral arrangements is to defend the debtor's position vis-à-vis an excessively favored creditor. Moreover, these contracts would circumvent the mandatory provisions of the secured transaction, which is unsupportable.[152] However, the abolition does not cover all title financing devices: the financial leasing, the factoring and the retention-of-title are not forbidden, and they are regulated in the new Code separately. The common feature of these devices is their financing element[153] and the well-developed sector-specific industry which surrounds them.

2.2.5 Conclusion

All the devices described above – the retention-of-title, the SCCRR, the purchase option for security purposes – contain a security element thereby breaking the monopoly of the secured transactions. As we have seen, they have both advantages and disadvantages, with the opinion of some jurists that the latter slightly outweighs the former. For these reasons they have been reviewed and reregulated by the new Hungarian Civil Code of 2013. The SCCRR and the purchase option for security purposes have been abolished, while the conditional sale has been supplemented by the vital rules of public registration. Though their fate was preceded by an extensive jurisprudential debate, the legislature decided the issue based on policy rather than theoretical-dogmatic considerations. The policy choice in Hungary is clear: the parties should turn to those security devices that are designed specifically for security purposes. These devices are the mortgage, the personal property security right and the bailment-security ("óvadék"). It is the view of the new

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151 Lajos Vékás, *Szakértői Javaslat az Új Ptk. tervezetéhez* (Complex Kiadó, Budapest, 2008) § 4:106
152 Kisfaludi (n 145) 153.
153 István Gárdos, 'Az új Ptk. megszünteti a fiduciárius biztosítékok okozta bizonytalanságot' <http://www.gfmt.hu/cikkek/az-uj-ptk-megszunteti-a-fiduciarius-biztositekok-okozta-bizonytalansagot.php> accessed 16 March 2015.

Civil Code that if security liens are properly regulated in the legal system, fiduciary securities will become almost superfluous, since their economic function is the same. However it is still true that in case of security right the prohibition of *lex commissoria* weakens the secured creditor's position, while in case of fiduciary securities, the parties may use their contractual freedom to tailor the existing contractual provision to their very needs.[154] In the following chapter I deal with the financial leasing, probably the most frequently used title financing device in Hungary which, as we shall see, had and still has a unique role among security devices and may serve as an adequate alternative to the secured transactions.

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[154] Szeibert (n 130) 12.

Chapter 3: Financial leasing

3.1. Financial leasing in the United States

3.1.1 The basic types of leasing and the definition of the financial leasing

There are different basic forms of leasing in the United States and the financial leasing is only one of them. Hence, we are dealing with (1) equipment leasing when merchant lessor "who deals in goods and holds itself out as having specialized knowledge about the design, operation and repair of the chattel leased". In contrast (2) a financial lessor (financial leasing) merely provides funds by purchasing the required goods and leases it to the lessee. The most practical difference of the distinction is that unlike the merchant lessor, the finance lessor usually disclaim liability for the equipment leased. (3) Consumer leasing is defined by the UCC. Basically it is a leasing for personal, family or household purposes. Furthermore under the (4) closed-end leasing upon the termination of the lease period the legal relationship ends between lessor and lessee and lessee return the leased object. However, under the (5) open-end lease the legal relationship does not end, since lessee may either renew the leasing or "make a balloon payment" (i.e., the remaining balance) and purchase the good. Naturally these types may mingle and it is perfectly reasonable to talk about for instance a closed-end equipment lease.

According to the UCC[155], the financial leasing is a three-pronged relation (supplier-lessor-lessee) and embraces two distinct transactions: (i) pursuant to the lessee's instructions the lessor purchase the goods from the supplier (sale transaction) and (ii) the leasing of the goods by the lessor to the lessee. Functionally financial leasing has the same economic function and internal logic as retention

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155 UCC § 2A-103(1)(g) (2002)

of title: though during the lease period the lessee is not owner of the leased asset, *de facto* he disposes of the asset as its own. The lease period is either as long as the economic life of the asset, or, if it is shorter, at the end of the term lessee either has an option to purchase the good for a nominal price, or he has to return the good to the lessor.

3.1.2 True lease v. security interest disguised as a lease

However, it may occur that the financial leasing is not what it appears to be, i.e., it is not a lease governed by UCC Article 2A but a secured transaction disguised as a lease. But what are the decisive factors that determine such a reclassification. The following analysis is an instructive example of the unitary model's operation in the practice.

The adoption of UCC Article 2A, which deals with leasing, solved a handful of practical problems. It was not necessary any more to apply a mixture of common law principles and UCC Article 2 (law of sales) in case of leasing, as it finally draw a distinction between true lease and security interest disguised as a lease. The distinction is not without importance: if the transaction qualifies as a secured transaction, Article 9 governs and the parties need to satisfy the conditions set forth therein. Otherwise, if the parties do not satisfy these conditions, they could face with the unpleasant situation that notwithstanding their intention, the title is transferred by operation of law and without the necessary filing, the creditor has only unperfected security on the asset. On the other hand, if the transaction qualifies as a true lease, it is within the scope of Article 2A, lessor does not have security interest but the title remains with him.

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There are two main reasons behind the use of security interest disguised as a true lease. First, in case of the debtor-lessee's default creditor-lessor has the right to repossess the goods[156] or in case of the debtor's bankruptcy, under the Bankruptcy Code[157], the debtor may assume, reject or assign the unexpired lease contract. If the debtor (or the trustee) assumes the contract, debtor's rights and obligations stemming from the lease become the estate's property and obligations[158]. If the debtor rejected it, the creditor might recover the asset from the bankrupt debtor's estate. Second, the creditor's retention of title would deprive third party purchasers of the collateral.[159] Third, the debtor might be subject to more favorable tax rules because he could not deduce security interest as a business expenditure, while rental payments were deductible.[160] Hence, at first sight it is beneficial to the parties to conceal the true nature of their agreement by various lawyering techniques. In order to prevent such misuses, the legislator had to come up with clear, foreseeable and objective rules of distinction. Though, as we shall see, such entirely predictable regulation has not been adopted, the UCC and the case-law provides well-founded guidelines for a predictable assessment which is presented below.

Accordingly, the most crucial issue is that how and where the distinctive line should be drawn. Under what conditions a contract, labeled as lease, qualifies as a secured transaction irrespective of the parties' intent? This has been "one of the most vexatious and oft-litigated issues under the Uniform Commercial Code."[161] If I were forced to highlight the most prominent difference I would

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156 UCC § 2A-535(2) (2002)
157 11 U.S. Code (Bankruptcy Code) § 365
158 David G. Epstein, Steve H. Nickles, James J. White, *Bankruptcy* (West Publishing Co., St. Paul, Minnesota, 1992) 448-49.
159 Gilmore (n 67) 76.
160 Richard F Duncan, *The law and practice of secured transaction: working with Article 9* (Law Journal Press, New York, New York, 2011) 238.
161 In re QDS Components, Inc., 292 B.R. 313, 323 (Bankr. S.D. Ohio 2002) (cited in Duncan (n 161) 238.

say that in case of a true lease the lessor retains a "meaningful residual interest"[162] on the asset, while it is usually a secured transaction when the creditor transfers the asset for its entire economic life. It is called the residual value test.[163] I show the test's relevance by the illustration of a case:[164] Within the framework of an agreement labeled as a lease, the lessee was required to pay taxes, to purchase the equipment from third party vendors without noticing the financial lessor about the sales and without the intention of ever returning the goods. The lessor, on the other hand, did not have the right of acceleration and recovery of the debt upon the lessee's default and most importantly, at the end of the leased period the lessee might have purchased the goods for a fair market value. So far, for the purpose of the transaction's unequivocal assessment, the circumstances contradict each other. Nevertheless, according to the residual value test, since the lessee could have purchased the goods for their fair market value, it seems that a significant portion of the goods' value remained with the lessor. Therefore it should be a true lease. However, in this particular case the goods (computer hardware and software equipment) were lost their substantive economic value at the end of the term, moreover, there were no real market for them. Therefore, as the Court stated, the lessor "did not have any ownership interest in the computer equipment and fixtures other than as collateral under a security agreement".[165]

As regards the UCC, § 1-203 codifies the jurisprudence crystallized in the heavily litigated case law.[166] Subsection (a) merely states that the issue "is determined by the facts of each case". Subsection (b) is more helpful: it provides four conditions and if one of them is met, the transaction is likely to be a secured transaction. These circumstances are the following: (i) the economic life of

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[162] Duncan (n 161) 242.

[163] David G. Mayer, 'True Leases Under Attack: Lessor Face Persistent Challenges to True Lease Transactions' (2005) vol 23., Journal of Equipment Lease Financing, 6. <http://leasingnews.org/PDF/ELFF_SpecialIssue_Fall05.pdf> accessed 26 March 2015.

[164] In Re The Answer – The Elegant Large Size Discounter, Inc. 115 B.R. 465 (1990) (reproduced in Tibor Tajti, Comparative Secured Transactions (Central European University, Budapest, 2014) 304.

[165] In Re Answer (n 165)

[166] Sepinuck (n 4) 109.

the goods is shorter than the term of the lease, (ii) at the end of the term the lessee must renew the lease until the end of the economic life, or purchase it, (iii)-(iv) the lessee may purchase or renew the agreement for the duration of the goods' economic life for no or nominal consideration. However, if the above conditions are not met, the transaction is not necessarily a true lease.[167] Further conditions for assessment are set out in subsection (c). These contractual terms of the lease may indicate that it is a secured transaction, but they are not decisive. For instance if "the lessee has an option to renew the lease or to become the owner of the goods" or the lessee pays all the taxes, insurance and registration fees, etc. incurred in relation to the goods we are probably dealing with a secured transaction.[168]

At this point it is worth to point out that the UNCITRAL Legislative Guide on Secured Transactions – albeit while dealing with acquisition financing – determines how the two types of transactions should be separated. According to the Guide, the decisive criterion is whether or not the lessee leases the asset "at least most of its useful life in exchange for notional rental payments that represents the economic equivalent of its price if it had been sold in an instalment sale."[169] If the lessee does so, it is a true lease. This definition, though a little bit simpler, essentially coincide with the US approach, since it restates the essence of the residual value test.

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[167] Ibid.
[168] UCC § 1-203(c) (2002)
[169] Guide (n 2) 325. para 31

3.2. Financial leasing in the Hungarian Civil Code of 2013

3.2.1 The definition of the financial leasing

The financial leasing is a newcomer contract type in the Hungarian Civil Code. Though it existed before as an atypical agreement in the practice, it did not get an autonomous regulation within the Code. However, due to its indisputable popularity, the legislature deemed its regulation justified. The regulatory concept of the Civil Code' Book of Obligations is the following: the first and second part deal with general rules of contracts (formation, termination, modification, etc.) and these rules apply to the specific contracts, unless it is otherwise provided therein. The Code regulates solely the financial leasing, leaving the operational leasing outside the scope of regulation.[170]

In the practice the underlying concept of the financial leasing does not differ from the US approach. The lessor finances the acquisition of the asset, chosen by the lessee. However, the rationale behind the financial leasing is not a conceptual element of the statutory definition since it is conceivable that the lessor is already owner of the leased goods. Moreover, if take a closer look upon the Code's definition we discover striking similarities between it and the criteria whereby the UCC qualifies a leasing contract as a secured transaction. The Code's definition states the following: We are dealing with a financial lease, if (i) the leased goods are owned by the lessor, (ii) if the lessee is entitled to the use of the goods during or even after their economic life, or, (iii) at the end of the term lessee may purchase the object for a nominal price of for without consideration if the term is shorter than the goods' economic life (iv) or the sum of the rental payments is higher than the market price calculated at the conclusion of the contract.[171] Another important conceptual element – which has

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[170] Hungarian Civil Code 2013, § 6:409-415.
[171] ibid.

been in practice even before the adoption of the Code[172] - is that contrary to the retained title of the lessor and the well-recognized principle of *casus nocet domino*[173] the lessee bears the risk of loss and expenses incurred in connection with the leased object,[174] while in case of operational lease it the major risks and expenses are borne by the lessor.[175] From these conditions, it is can be inferred that the fundamental difference between the operational and the financial leasing is that in case of the latter the lessee gets the economic ownership of the leased object.[176] This difference is nothing else that the difference we have seen in case of true lease and lease disguised as a secured transaction in the United States. The sale and lease-back transaction – where the initial owner is the lessee – is within the scope of financial leasing as well. Therefore, though the Civil Code prohibits the fiduciary securities in general, the sale and lease back qualifies as another exception from the Code's rule.[177]

Furthermore, it is clear from the statutory definition that the Hungarian financial leasing is an acquisition financing device[178] by virtue of the UNCITRAL Guide's definition. Nevertheless, since the financial leasing's regulation rests upon the logic of sales law, it is justified to see how the Hungarian legislator reaches the same functional outcomes by different means as a secured acquisition financing device.

The first and probably the most important part of this harmonization is the filing requirement. If the leased object is a personal property, the lessor has to register the fact of the transaction and the

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172 Fővárosi Bíróság ("Capital Court") Gf.75.017/2000/7.
173 Tekla Papp, 'A lízingszerződés a bírói gyakorlat tükrében' (2011) 6. évfolyam 1. szám, Miskolci Jogi Szemle, 40.
174 Hungarian Civil Code 2013 § 6:412 (1)
175 ibid 6:335 (1)
176 Péter Gárdos, A Polgári Törvénykönyv magyarázatokkal, (Lajos Vékás ed, Complex Kiadó, 2013) 874.
177 ibid 873.
178 ibid 875.

identity of the lessee to the chattel register.[179] The example of third party effectiveness (the in rem effect) clearly shows that the function of registration correspond with the function of filing under the US law. In Hungary, if the registration is missed and a bona fidei third party purchases the leased object for consideration, he will be the legitimate owner of the object, irrespective of the lessor's retention of title.[180] As per UCC Article 9, the secured party maintains his security interest, even if a bona fidei third party purchases the goods (unless the secured creditor authorizes the unencumbered purchase).[181] However, if the secured creditor does not perfect its interest, as an unsecured creditor he will be vulnerable to bona fidei purchasers, whereas they may acquire the goods free from any interest attached to it.[182]

3.2.2 What happens if the lessee breaches the contract?

If the lessee fails to pay the rental payment, the whole balance become due and payable. According to the pre-Code judicial practice,[183] the lessor might have chosen whether he would repossess the leased object and resort to remedies upon termination of the contract, or claim the total unpaid balance of the rental payment. However he could not claim both, even if the contract provided so.[184] In the new Code, the functional equivalence of security devices is assured by the provision that in case of renunciation, the lessor should account with the balance according to the rules of secured transactions.[185] This very symbolic provision creates the harmonization in case of the debtor's default thereby more and more blurring the differences between the financial leasing and the secured transactions.

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[179] Hungarian Civil Code 2013, § 6:410(2)
[180] Gárdos (n 177) 875.
[181] UCC § 9-201(a), § 9-315(a)(1)
[182] UCC § 9-317(b)
[183] Tekla (n 174) 43.
[184] Gárdos (n 177) 877; Tekla (n 174) 43-44.
[185] Hungarian Civil Code 2013, § 6:415 (2)

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Conclusion

It is undeniable that the unitary model has not had a great career in Europe so far.[186] Even its sole advertiser, the Draft Common Frame of Reference Book IX. is nothing more than a scholarly model law. However the Thesis came to the conclusion that there is nothing in the fundamental idea of the unitary model that has not already been recognized and adopted at least by the recently adopted Hungarian Civil Code.

As it was developed above, the Hungarian Civil Code inaugurated the general prohibition of the title financing devices save some very important transaction types, such as the financial leasing. The Thesis justified that the almost untraceable variegation of the title financing devices before 2014 gave place never-ending and sometimes too technical theoretical debates over highly abstract legal concepts (e.g., causa, shammed contract, valid title). Even the courts could not decide unequivocally to which side to stand. On one hand the lack of proper regulation enhanced the unpredictability of the credit economy and on the other hand rendered the secured transactions superfluous. Thus, the Hungarian legislature faced the same challenge as the drafters of UCC Article 9 had faced decades ago. The situation was similar: the drafters of the UCC had to come up with a practical, simple and cost-efficient structural solution in order to overcome the abundance of different security devices throughout the United States.

Their solution, the unitary model, is very similar to the Hungarian one, since both of them recognizes that the economic purpose of title financing devices and secured transactions is essentially the same. Therefore these devices requires a regulatory structure which provides the

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[186] Tajti (n 51) 151.

same legal effects for both of them. Though the unitary model and the Hungarian reform aim at the same outcome, in a sense, they are mutually antagonistic regulatory approaches. While the unitary model adopts a "positive" approach and opens the scope of Article 9 as broad as possible, the Hungarian Civil Code prescribes the general prohibition of the functionally non-harmonized title financing devices. Nevertheless, the outcome is the same, since in both systems only those devices obtain high priority rights which fulfill the law's requirements. The UCC achieves it by mandatory filing and attachment conditions while the Civil Code by prohibition.

Since the financial leasing is an exception to the prohibition, the Hungarian legislature availed himself of option 4.-policy choice of the Guide[187] and functionally harmonized the security devices that fell outside the scope of secured transactions.[188] The analysis of the financial leasing, which is *per definitionem* a secured transaction under the US law, proved that within the framework of the Civil Code the harmonization has been achieved.

Consequently, as the example of the Hungarian Civil Code proves, despite the aversion vis-à-vis the unitary model in Europe, its fundamental idea (i.e., to treat all the personal property security devices in a functionally equivalent way) ought not to be bypassed if a country is determined to develop a well-functioning secured credit system.

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[187] See Section 2.1.2.

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