SECURED CREDIT VERSUS TITLE SECURITY: SHOULD THEIR COMPETITION BE ALLOWED IN THE RUSSIAN FEDERATION?

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Abstract

The thesis is a comparative analysis of the laws on title security (e.g., leasing, sale with retention of title clause and other contracts that rely on transferred– and retained-title as security) and secured credits (e.g., pledge, chattel mortgage) as two classes of security devices which use movables and intangible assets as collateral. The quintessential issue is whether laws used for secured credit should apply to title security in Russia given that functionally both secure credits? The question is legitimate for two main reasons. On one hand, all the leading common law jurisdictions have subjected title finance transactions to the same legal regime that applies also to secured credit. Moreover, some civil countries have taken steps in that direction, too. The prototype of this unitary model is enshrined into Article (chapter) 9 of the US Uniform Commercial Code[1].

On the other hand, most of title security transactions in Russia today are concluded in the form of sale and lease agreements, and, consequently, the laws on 'sales' or conventional 'lease' contracts apply by analogy[2]. These laws, however, often produce inequitable and results ill-suited to modern business needs as they were not formulated having title security in sight. At the same time, the laws on secured credit address all the necessary issues that could arise during its use more appropriately. Due to the absence of necessary uniform rules, court practice is forced to find suitable solutions and fill these gaps in legislature. The current situation has an adverse effect for parties of title security agreements the security nature of which is uncertain. Consequently, the

[1] James J. White, Robert S. Summers, *Uniform Commercial Code* (6th edn, Thomson Reuters 2010) 1149.

[2] It should be noted that the connotation of the English phrase 'by analogy' as per Russian legal theory is not equal with the 'analogy of statute rule,' or application of a certain provision of a statute by analogy as opposed to 'analogy of law' meaning application of general legal principles under Article 6 of the Civil Code of the Russian Federation. Analogous application is justified by a direct requirement of Articles 454 and 625 of the Civil Code of the Russian Federation.

main argument of the thesis is that the analogous application of sale and conventional lease regulation is inadequate and negatively affects access to credit. It rather vouches for such a more balanced regulation of these transactions which would take into account the interests of all stakeholders and is thus the model Russia should embrace as well.

To support these arguments, the thesis juxtaposes the laws and experiences of jurisdictions exemplifying the two approaches. On one side, this includes the conventional dualistic approach of English law (as supplemented by UK law, if any) and the Romano-Germanic jurisdictions (to the latter group Russia belongs to as well), which continue to treat title finance separately from secured credit. As opposed to that, the analysis is based on international guidelines, particularly Book IX of the Draft Common Frame of Reference and the UNCITRAL Legislative Guide on Secured Transactions, both of which were heavily influenced by the unitary approach of US law.

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Introduction

1. The hypothesis of the thesis

Extending loans and providing easy access to them are essential for support and development of business in modern economic conditions. Lending could be possible only if a creditor is sure that it will get the borrowed funds back. To avoid the risk of the debtor's failure to perform its obligation, the parties use various types of proprietary security devices, which as in rem transactions grant rights to the creditor in the asset used as collateral. These are normally deemed to be the most efficient devices in protecting creditors' interests and indeed this thesis will focus on them.

In Russia, for example, today the most popular type of security devices besides secured credit (e.g., pledge, mortgage) are various contracts concluded as 'sales' or 'leases' but containing, for instance, retention of title (ownership) clauses. The latter are lately known also as title finance transactions. The problem is that albeit secured credit and these title finance transactions perform the same function of securing the extended credit and both use movables as collateral, different procedures apply to enforcing the creditor's claims in the case of the debtor's default. The procedure for enforcement of secured credit could be long, expensive for the creditor and bears other risks[3], and in fact one of the key reasons title financing appeared in Russian business practice was linked to the desire to overcome all inconvenient requirements prescribed by national statutes for secured credit.

As said, title finance instruments are usually concluded in the form of lease or sale agreements in

[3] Philip R. Wood, *Comparative Law of Security Interests and Title Finance* (Sweet & Maxwell 2007) 675.

Russia accompanying by specific terms which are intended to ensure that a debtor will pay the amount of money that has been agreed upon. As title finance transactions are forms of supplier and not banking finance, in these agreements credit is provided under the condition that during the term of the agreement a debtor pays a creditor a principal amount with interest in instalments, and collateral remains owned by the creditor. In substance, in Russia and other Romano-Germanic systems having the same approach, title finance transactions are similar to traditional forms of secured credit where a creditor provides funding (loan-credit) but has just a right to settle its claim from the price obtained from the sale of the collateral default only but has no right to become its owner. Title security and secured credit are very similar in their essence, however, thanks to the right to keep the collateral instead of being forced to go through the complex process of selling that collateral, title security is much more convenient for the creditor at present time. In the case of the debtor's failure to recover the money under secured credit, the creditor just has a right to discharge its claim from the money received after disposition of a collateral which is well-regulated and imposes a number of obligations on a secured creditor. In similar circumstances according to title security, the creditor as an owner of a collateral is not obliged to go through a special enforcement procedure. The creditor just can retain the property served as a collateral in settlement of a debt without following any procedures keeping a spread between the debt amount and the collateral value.

As it could be seen from the above, the main difference between title security and secured credit is related to the stronger position of the title security creditor. It occurs through the infringement of the debtor's rights and fair balance between creditor's and debtor's interests. As a result, secured credit obviously is less beneficial than title security from the creditor's perspective.

Title security is not *terra incognita* for private law of numerous jurisdictions. However, many

jurisdictions *de jure* do not admit the security nature of title security devices and try rather to apply to these the provisions of either sale or lease law. For instance, the Russian Civil Code has separate provisions on several types of title security in addition to a distinct chapter devoted to secured credit[4]. However, all these contracts which fall within the scope of title security are subsumed under the Code's chapters on sale or lease. These provisions are laconic and give no grounds for their perception and interpretation as proprietary securities. As a result, such regulation does not reflect their real legal nature and leads to their misunderstanding by courts and parties.

At the same time, the Code's provisions on secured credit do go into detail on such key corollary issues as priority, enforcement and allocation of proceeds. For example, a secured creditor should share a part of proceeds after sale of a collateral with other creditors to maintain the balance between interests of secured and unsecured creditors. However, these rules are not applicable to title security transactions because title security is conceptually distinct, and the rules on sales and leases are apply to them by analogy. The central argument of this thesis, in light of the above, is that the analogous application of sales and conventional lease law is inadequate and negatively affects access to credit.

Consequently, the aim of this thesis is to analyse how secured credit and title security should be regulated. This research question constitutes the primary base for further issues to be examined in this thesis. The subsidiary questions that flow from the central issue are what secured credit and title security mean, how they are regulated in different jurisdictions, what differences exist in their regulation, what approach should be preferred to maintain a fair balance between the debtor and the creditor and which measures should be undertaken to implement such approach.

[4] Civil Code of the Russian Federation 1994, art 491, art 624, s 6 ch 34.

2. The compared jurisdictions and the concomitant terminology choices

The proper understanding of the dilemmas Russia faces today requires critical comparison of the two main approaches known today internationally. On the one hand, the thesis analyses the dualistic approach embraced – besides Russia – also by English law (as supplemented by the laws of the United Kingdom, if any) and Germany. While English law's influences remains strong in its former colonies throughout the world, German law has served as sources of inspiration primarily for many continental European jurisdictions including Russia. The approach they employ, as highlighted above, is separate treatment of title security and secured credit devices. Russia here figures not only as one of the examples of this group, this approach but also the jurisdiction the laws and practices of which are resorted to herein to demonstrate the problems that are corollary to such dualistic approach.

To show what the advantages of the so-called unitary approach are, the laws of the United States (US) are resorted to, in particular Article (chapter) 9 of the Uniform Commercial Code (UCC). The great innovation of the US system lies in its functional approach that brought under the same system both, title security and secured credit[5]. The US system is one of the most progressive legal systems in the secured transactions area whose approaches were taken over not only by many international instruments[6], but also by Australia, the Canadian provinces, New Zealand and in the 1990s also by most of the Central and Eastern European countries transiting from socialism to market economies. This approach suggests using the uniform rules for title security and secured

[5] Tibor Tajti, 'Could Continental Europe Adopt a Uniform Commercial Code Article 9-Type Secured Transactions System? The Effects of the Differing Legal Platforms' (2014) 35(1) Adelaide Law Review <http s://ssrn.com/abstract=2512802> accessed 6 June 2020.

[6] Model Law on Secured Transactions 2016 (United Nations Commission on International Trade Law [UNCITRAL]) UN Doc A/71/136; Model Law on Secured Transactions 2010 (European Bank for Reconstruction and Development); Christian von Bar and Eric M. Clive, *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)* (European Law Publishers 2009).

credit. Such approach promotes the competition between different types of lenders by creating uniform rules for funding and forcing lenders to engage new clients by offering more attractive commercial terms than other financiers.

Needless to say, the different approaches of these two groups of legal systems are reflected also on the nomenclature used by them. To start with, as the essence of the unitary concept of security interests (i.e., consensual proprietary security rights) is bringing all proprietary security devices on personal property (i.e., movables, intangibles and rights) under the same systems, the drafters of the UCC Article (chapter) 9 had to simplify the terminology as well. Hence, the common designation of all the covered transactions is the expression 'secured transactions,' the proprietary rights have become named 'security interests.' In other words, under US law the expression 'secured transaction' or 'secured credit' extends to both title finance transactions and to secured credit devices. Such terminology changes have not occurred in the other jurisdictions within the purview of this thesis. For the purpose of the present thesis where different jurisdictions, not only US, will be discussed, to examine traditional in rem securities and title security devices separately, show reasons of their emerging and their differences under the dualistic approach and reconcile the differing nomenclatures, in this thesis 'traditional proprietary security devices' or 'secured credit' will be used to illustrate classic proprietary securities such as pledge and chattel mortgage, and 'title security' will be used to describe transferred- and retained-title security devices. The only exception will logically be the US where 'secured transactions' will mean all kinds of in rem (proprietary) security devices on movables, intangibles and rights.

3. Methodology and bibliography

The research will be mainly based on the analysis of the primary sources of law comprising of

codes and statutes taking into account their interpretation given by case law, and international model documents concerning to secured transactions with a special focus on title security with employment of comparative and historical methodologies.

The main factors impacting the research in the dualistic approach part was a lack of case law which should address all challenges arising due to the gaps in legislation to resolve pending problems. In Russia, most books and articles are focused on separate types of title security devices[7]. They are focused on discernible differences rather than on their common features. Such approach leads to a piecemeal interpretation and frequent amendment of civil law provisions, lack of systematic understanding of them and incomprehension why it is necessary to have uniform regulation for these transactions. It is obvious that current academic works are not sufficient to make final conclusions with regard to title security regulation, and there is a need of complex research which will reflect modern international tendencies of title security developments. Due to such sharp differentiation, courts are in Russia expected to find suitable solutions and fill the gaps and inconsistencies in legislature. The current situation has an adverse effect for parties of title security agreements security nature of which is uncertain.

4. The roadmap to the thesis

The main body, the substantive law of the thesis is divided into two chapters, in addition to this introduction and the conclusions. The first chapter is dedicated to explanation what traditional proprietary security and title security mean providing examples and their place among other

[7] Yulia Alferova, 'Notion of Retention of Title Clause' (2014) 3 Civil Law Review 7; Sergey Gromov, *Security Function of Lessor's Ownership on Asset under Finance Lease. Security Devices and Civil Liability in Civil Law* (Statut 2010); Olesya Lanina, 'Security Function of Retention of Title Clause: Experience of Leading Foreign Jurisdictions' (2011) 6 Civil Law Review 102; Pavel Khlustov, Repo: The Problem of Bankruptcy Estate Formation.' (2013) 3 Statute 141.

transactions, discussing their common features, their particularities and advantages. The second part of the first chapter explains why there is a competition between these two devices and why title security could look more beneficial. The second chapter provides an overview of modern approaches to regulate traditional proprietary security and title security, assesses their effectiveness and proposes the unitary approach concept which should be taken into consideration by legislators which did not accept it yet. It is also indicated which changes a country should accept to switch to the unitary approach and the benefits which a country could receive after such transition resulting in uniform rules for the country on the example of Russian legislature.

Chapter 1. The concepts of secured credit and title security

1.1. The scope of secured credit and title security

In this chapter, there will be made an attempt to determine the theoretical concept of traditional proprietary security and title security and discuss what are these two devices, what are their essential characteristics, which of them are similar and which of them are not. This analysis will assist in understanding of the main approaches to their regulation which will be examined in the following chapter.

Starting a talk about secured credit, it is worth noting that secured credit is a security of obligation to repayment under a loan agreement. This security in the present thesis refers to all kinds of traditional in rem securities as pledge, charge[8], mortgage, lien. As was already said, in the present thesis, this term does not cover title security which is not recognized as equal with proprietary securities by law in numerous countries; herein this applies to Germany, Russia and the UK. Traditional proprietary security is one of the most ancient transactions which was already known in ancient Rome. The content of these transactions is pretty clear. In a secured credit, a creditor provides to a debtor funding while the debtor provides its property as a collateral to the creditor. This means that in the case of the debtor's default, i.e. failure to return money back to the creditor, the creditor is entitled to sell the property serving as a collateral and use the received money to repay the debt[9]. Therefore, the creditor has a specific right in the case of the debtor's default to dispose the asset served as a collateral and deduct the debt amount from the price.

[8] Specific security device in English law. Michael Bridge, 'Cross-Border Security over Tangibles: England and Wales' in Eva-Maria Kieninger and Harry C. Sigman (eds), *Cross-Border Security over Tangibles* (Sellier 2007) 147.
[9] See, for example, Article 334 of the Civil Code of the Russian Federation.

While traditional proprietary security is well-studied in many jurisdictions, title security is a comparatively new concept which requires additional explanations. Title security contracts are mainly concluded in the form of sale or lease contracts with specific conditions, for example, retention of title clause. After analysis of their content, it could be concluded that these contracts are purely financial secured transactions because they have a similar commercial effect as traditional proprietary security and, as a result, could be characterized as its substitute[10]. That is why they are frequently called "quasi security"[11].

All transactions which constitute title security could be divided into several categories. First, there is a classification according to a financing party: a seller in a purchase contract with retention of title clause, a buyer in factoring contracts, repurchase contracts or securitization, or lessor in finance lease, hire purchase or sell and lease back contracts[12].

Second, they could be designed through a transfer of a title or a retention of a title. In the transfer of title model, the title could be used as security for loan agreements when a debtor transfers ownership of its property to a creditor[13]. The example of such contracts could be repurchase contracts when a debtor sells its property, for instance, apartment or car, to a creditor with a condition that the debtor will buy this property from the creditor later paying an increased price which includes amount of finding with interests. These agreements with regard to shares and bonds

[10] Wood (n 1) 28-29; Hugh Beale, Michael Bridge, Louise Gullifer, Eva Lomnicka, *The Law of Security and Title-Based Financing* (2nd edn, Oxford University Press 2012) 237.
[11] Wood (n 1) 670; Law Commission, *Company Security Interests: A Consultative Report* (Law Com No 176, 2004) 33; Law Commission, *Registration of Security Interests: Company Charges and Property Other and Land* (Law Com No 164, 2002) 2; Gerard McCormack, 'Pressured by the paradigm. The Law Commission and company security interests' in John de Lacy (ed), *Personal Property Security Law Reform in the UK: Comparative Perspectives* (Routledge 2009) 89.
[12] Wood (n 1) 28.
[13] Some authors call this type of secured transactions *fiducia cum creditore*. See Bram Akkermans 'Property Law' in Jaap Hage and Bram (eds), *Introduction to Law* (Springer, 2014) 83.

are frequently met in capital markets area for receiving funding and called 'repo'. In these contracts, funding is not purpose-oriented, i.e. obtained funds could be used at the debtor's discretion, for instance, for payment of wages, expansion of production, acquisition of real estate, marketing, etc. In retention of title model, the title could be used as a security for performance of obligation to pay a purchase price when a seller or a lessor retains a title on sold or leased property till the moment of full payment[14]. Such agreements are usually called acquisition financing or asset-based finance[15] because the funding is used only for acquisition of a certain asset, not for other purposes. As a result, title finance is not fully overlapping with acquisition finance because title finance also includes transfer of title devices.

For instance, in the UNCITRAL Legislative Guide on Secured Transactions, the notion of acquisition financing covers all kinds of secured transactions which allow to acquire property on credit[16]. This type of transactions takes place when funding is used for a certain purpose to provide a buyer or a lessee with the option to acquire goods with use of retention of title on these goods by a creditor[17].

The acquisition financing transactions are mainly associated in business practice with sale with retention of title clause, hire purchase and finance leasing which are widely known in numerous jurisdictions. According to retention of title clause, a seller remains an owner of goods until a buyer pays a full purchase price. Meanwhile, the buyer obtains possession and can use the sold goods. Hire purchase is a lease contract according to which right to purchase could be exercised after

[14] Legislative Guide on Secured Transactions (2007) (United Nations Commission on International Trade Law [UNCITRAL]) UN Doc A/63/121, 57.
[15] Wood (n 1) 670.
[16] Legislative Guide on Secured Transactions (n 34) 320.
[17] ibid.

payment of all regular payments constituted the major part of the asset's price at the end of the contract[18]. Under finance leasing contract, a lessor buys an asset, remains an owner of the asset and transfers it for use to a lessee while a lessee pays to a lessor lease payments during its service life. Payments under mentioned contracts paid by debtors actually constitute a price of an asset with total interest amount. All these devices could be replaced with loan agreements and nonpossessory traditional proprietary securities.

The idea of separation between traditional proprietary security and title security has been perceived on international level as well. As a clear example of above mentioned division in Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements which has a very specific scope and deals only with capital markets securities, several types of financial secured transactions are mentioned[19]. The secured contracts are divided into two groups: title transfer financial collateral arrangement and security financial collateral arrangement[20]. The title transfer arrangements include repo and other agreements according to which a debtor transfers ownership of a property serving as a collateral to a creditor as a guarantee of performance its financial obligation[21]. At the same time, security arrangements are distinctive in that the ownership of a collateral always remains with a debtor[22]. The similar concept contains in English law[23].

As a result, title security could be characterized as a proprietary security of the debtor's performance of its money obligation by transfer to a creditor ownership of a collateral or retention

[18] Wood (n 1) 674-675; Beale (n 10) 255-260.
[19] Parliament and Council Directive (EC) 2002/47/EC of 6 June 2002 on financial collateral arrangements [2002] OJ L 168, art 2 (1) (a) - (c).
[20] ibid.
[21] ibid.
[22] ibid.
[23] The Financial Collateral Arrangements, SI 2003/3226.

of title on a collateral. Title security transactions could be substituted with traditional proprietary security because they have the same function to discharge creditor's claim from a value of a collateral.

1.2. Reasons for competition between secured credit and title security

Historically, one of the factors why title security became widespread in commercial practice was the intention of creditors to get a "stronger" right to protect their interests and avoid the application of traditional proprietary security laws which contain inconvenient requirements, in particular, incapability to exploit the collateral to generate income due to the transfer of possession into the hands of the creditor (or its agent) until repayment of debt, time-consuming and expensive foreclosure of a collateral[24].

In many jurisdictions, there is a prohibition of secured transitions with tangible goods without a transfer of its possession into the hands of the creditor. Since nonpossessory secured transactions initially were not recognized, creditors and debtors sought other instruments allowing to overcome such requirement. For example, the advancement of German fiduciary transfer, or the "invention" of hire-purchase in England were the logical outcome of the initial hostility and prohibition of non-possessory securities, the first version of which in England was the chattel mortgage[25]. Today, in many European civil law countries, the chattel mortgage, somewhat erroneously, is known as 'registered pledge'[26].

As a result of such development, there might appear that the debtor is trustworthy, has title or owns

[24] Wood (n 1) 28.
[25] Wood (n 1) 677.
[26] Polish Law on Registered Pledges and the Pledge Registry 1996.

the asset because it possesses the asset which is legally owned by a creditor[27]. The secret asset encumbrance, so-called problem of "ostensible ownership", makes less protected positions of other creditors of a debtor and forces third parties to rely on information provided by a debtor due to lack of publicity and spend time and money to find information in other recourses[28]. That is why in many jurisdictions such as Austria and Switzerland nonpossessory secured transactions with movable property are still prohibited[29].

Moreover, without special rules on this matter, title security priority is deemed to be ranking higher than the priority afforded to secured creditors without bearing risks of discharging its claims only after other secured creditors. In the case of failure to perform the debtor's obligation, the creditor is in a better position as an owner than a secured creditor. Especially, it is fair with regard to the debtor's bankruptcy proceedings when a property serving as a collateral is removed from the debtor's bankruptcy estate while a collateral under traditional proprietary security is included in the debtor's bankruptcy estate. Moreover, title security creditor as a full owner can determine the legal fate of this property without any need to get approval from anyone to exercise its powers[30].

Secured creditor under traditional proprietary security faced with a competition for assets with junior creditors, and, when an asset is sold, it should account about surplus because it has a claim including only a principal amount and interest. Title security creditor as an owner has a priority over other creditors, and, when an asset is disposed, it has a right to get a surplus entirely[31].

The second factor, not less important, explaining frequent use of title security in commercial

[27] Beale (n 10) 770-771.
[28] Legislative Guide on Secured Transactions (n 34) 51-55; Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (Cambridge University Press 2002) 115.
[29] Wood (n 1) 677-678.
[30] Roy Goode and Louise Gullifer, *On Legal Problems of Credit and Security* (Sweet & Maxwell 2008) 251.
[31] Beale (n 10) 237-238.

practice is accessibility of credit. To buy an asset, a buyer can borrow money from a bank. However, this opportunity could be unavailable for the buyer because its credit rating makes completely inaccessible getting a credit or makes it very expensive[32]. Conditions of credit extension are dependent on many factors such as credit history, financial reports, etc. These factors determine whether the risks of non-payment are high. If the results of the buyer's financial assessment are not satisfactory, then the interest rate for credit facility use will be higher than for a borrower with more reliable financial performance.

To make the interest rate for credit facility lower, the parties use secured transactions. A collateral could be any property of a buyer such as real estate, equipment, etc. However, the most obvious option and often the only option which a buyer has is use of an acquired asset as a collateral[33].

To overcome this problem, the parties use different contract instruments to cut down the risk of non-payment and make credit cheaper. For instance, a buyer can agree with a seller on purchase goods on credit when a buyer can pay for the goods later, after conclusion of a purchase agreement. In this case, a seller immediately transfers the goods to a buyer, however, gets the purchase price later, as usual, in installments. This scenario does not essentially differ from extending a credit by a bank except that the risk of non-payment rests with a seller, not a bank.

In addition, in classic secured transactions banks as creditors are not attracted by movable property as a collateral. For example, the Model Inter-American Law on Secured Transactions was adopted by Sixth Inter-American Specialized Conference on Private International Law in 2002 where such

[32] Legislative Guide on Secured Transactions (n 34) 322.
[33] ibid.

countries as Argentina, Uruguay, Brazil, Chili, Mexica, Canada and the USA participated[34]. The main idea of this law is harmonization of legislations of Latin America countries and stimulation of their national economies by improving access to loans. For developing countries such as Latin America countries, access to credit is a main issue for small and medium businesses because they do not have real estate which is considered as an only possible type of collateral. That is why their needs of credit are not satisfied. Movable property is not considered by banks as collateral there because it has usually low value, and there are a lot of difficulties with its foreclosure. Otherwise, in developed countries such as the USA the majority of extended loans are secured by personal property which includes movables and receivables[35].

Thus, without special regulation equating rules on title security and traditional proprietary security, title security provides much more benefits than traditional proprietary security. First, it allows to overcome the mandatory formalities that tend to be an additional burden on secured creditors. Second, it allows a debtor to get a credit even when classic lending is not accessible. However, all these comes at the price of increased risk as far as the recharacterization of title financing are concerned.

[34] Model Inter-American Law on Secured Transactions (2002) (Sixth Inter-American Specialized Conference on Private International Law) CIDIP-VI/RES. 5/02.
[35] Gerard McCormack, *Secured Credit Under English and American Law* (Cambridge University Press 2004) 74.

Chapter 2. The regulation of secured credit and title security

2.1. Modern approaches

In this chapter, based on analysis of main characteristics of secured credit and title security, the modern approaches to their regulation will be explored, and there will be discussed which approach is the most appropriate to retain a fair balance between a creditor, a debtor and its other creditors.

As was already noticed, title security is definitely similar with traditional proprietary security in its function. That is why the main question is whether prohibitions and restrictions related to traditional proprietary security should be applied to title security. Jurisdictions answer this question differently: some tends to recharacterise title security into traditional proprietary security, some others do not recharacterize or recharacterize only in bankruptcy proceedings[36]. For example, in English law title security transactions are not recharacterized into traditional proprietary security and do not require registration as for secured transactions which means that jurisdiction takes into consideration the intention of parties on their form and following legal regime governing such form[37].

The answer on the question stated above primarily depends on two aspects. First, it needs to be admitted that introduction of title finance was a positive step because it made an access to finance easier for debtors. In many countries, such title security financing usually provided by suppliers is widely used as an alternative to bank lending and has a preferential status due to its important function for small and medium businesses. However, second, to further promote banking financing it is needed to implement the unitary approach; including attributing super-priority to some specific

[36] Wood (n 1) 53.
[37] Wood (n 1) 29.

transactions.

Moving forward, it is to be noted that the prevailing approach nowadays is that title security transactions are not recognized as secured transactions, except the USA and countries under its influence, and treated according to the type of their contract. This approach was supported in the United Kingdom and Roman-Germanic jurisdictions such as Germany, Russia, Poland, Switzerland, Turkey, etc. Practically, it means that there are two different blocks of legislation, first, about traditional proprietary security devices and, second, on transactions which constitute title security. Norms on proprietary security transaction are not applicable to title security, even by analogy. As a result, title security transactions are regulated by norms on sale and lease which are designed for ordinary contracts and do not contained specific rules for contractual relations which have security nature. Consequently, this misinterpretation infringes rights of debtors whose right are better protected in traditional proprietary security.

To illustrate the above-mentioned, Russian legislation will be analyzed. Norms on title security and traditional proprietary security are located in different chapters[38]. Traditional proprietary security is placed in a separate chapter[39]. It contains all necessary provisions on terms of the security such as what property could be used as a collateral[40], conditions for registration[41], rules on priority[42], enforcement through public auction if the debtor fails to perform its obligation[43] including the obligation of the creditor to give back a surplus after enforcement[44]. At the same time, title security provisions look more meagre. Purchase contract with retention of title clause

[38] See Civil Code of the Russian Federation ch 23, art 491, art 624, s 6 ch 34.
[39] Civil Code of the Russian Federation ch 23.
[40] Civil Code of the Russian Federation art 336.
[41] Civil Code of the Russian Federation art 339.1.
[42] Civil Code of the Russian Federation art 342.1.
[43] Civil Code of the Russian Federation art 350.
[44] Civil Code of the Russian Federation art(s) 334 (3), 350.1.

(*kuplya-prodazha s ogovorkoy o sokhranenii prava sobstvennosti za prodavtsom*) is governed only by one article in the chapter on sale agreements[45]. Moreover, the general provision on purchase could be applied by analogy. The same situation is observed with other types of title security. Purchase-lease (*arenda s pravom vykupa*) is regulated by one article in the general provisions on lease agreements section[46] while finance lease (*finansovaya arenda*) provisions occupy six articles in a separate section[47]. Consequently, title security provisions lack all details for the most crucial issues such as registration, priority, enforcement which are contained in the chapter on proprietary secured transactions.

As it could be seen, title security devices circumvent mandatory norms on traditional proprietary security which were designed to protect a balance between interests of both parties concluded a contract and third parties such as other creditors of the title security debtor. Meanwhile, the positions of a creditor and a debtor are well-balanced in proprietary security devices. The last implies a special procedure on foreclosure, usually public auction which helps to attract more potential buyers normally leading to a higher price. In the case of title security, the creditor referring to its ownership could just retake the asset without giving the debtor a surplus if a value of the asset exceeds the amount of a debt.

The same problem appears in Russian bankruptcy proceedings. All debtor's property on the date of initiating bankruptcy proceedings are included in the bankruptcy estate of the debtor[48]. Therefore, in the case of bankruptcy of title security debtor a collateral will be removed from its bankruptcy estate because it is not *de jure* an owner of the asset. As a result, the creditor does not

[45] Civil Code of the Russian Federation art 491.
[46] Civil Code of the Russian Federation art 624.
[47] Civil Code of the Russian Federation s 6 Chapter 34.
[48] Federal Law of the Russian Federation on Insolvency (Bankruptcy) 2002 art 131.

account for a surplus and does not share surplus with other debtor's creditors. The opposite situation is when the parties chose traditional proprietary security. The collateral is a part of the debtor's bankruptcy estate, and the secured creditor gets only the amount equal to its claim, including interest and costs, and is obliged to share 20-30% of proceeds with other creditors[49]. As it could be seen in traditional proprietary security model, the secured creditor's powers are quite restricted in comparison with position of a title security creditor. The last approach could be recognized as quite well-balanced because it does not allow to the creditor just simply retain a collateral requiring to dispose a collateral and take only the amount of the corresponding claim. It is a leading pattern in many jurisdictions which prohibit an absolute foreclosure, so-called *lex comissoria*, which means that the creditor keeps a collateral without a public auction in the case of the debtor's failure to perform its money obligation[50].

The second approach to treat title security and traditional proprietary security is totally opposite and suggests applying to all security devices in rem uniform rules[51]. The main idea of this approach is that nonpossessory and possessory secured transactions, transfer of title and retention of title devices have common principles led to the same economic results[52]. As a result, economic content and function of a device should prevail over a legal form.

This idea was firstly developed in the US where trade between states was accompanied by different laws applied in different states during many years[53]. Article 9 of the UCC was designed to

[49] Federal Law of the Russian Federation on Insolvency (Bankruptcy) 2002 art(s) 134 (4), 138.
[50] Joseph Story, *Commentaries on the Law of Bailments: With Illustrations from the Civil and the Foreign Law* (The Lawbook Exchange, Ltd. 2007) 234.
[51] Legislative Guide on Secured Transactions (n 34) 55.
[52] ibid.
[53] Anjanette Raymond, 'Cross-Border Secured Transactions: Ongoing Issues and Possible Solution' [2011] 2 Elon Law Review 92; Kenneth C. Kettering, 'Harmonizing Choice of Law in Article 9 with Emerging International Norms' [2010] 46 Gonzaga Law Review 240.

harmonize different types of secured transactions in one system[54]. There is no difference between traditional proprietary security and title security in spite of their distinct legal form because they serve the similar economic purposes[55]. As a result, the UCC requires to consider all contracts from functional perspectives, and if they are aimed to secure obligations, the uniform regulation should be applied to them[56].

Such idea of the unitary approach was perceived by a number of other countries such as Canada, Australia and New Zeeland[57] and formed a basis for the Model Inter-American Law on Secured Transactions[58], the EBRD Model Law on Secured Transactions[59] and the Draft Common Frame of Reference[60] which equites traditional proprietary security with transfer and retention of title instruments[61]. The last one shows that even leading European experts who participated in its development, including German legal experts, admitted that the unitary concept should be commended.

[54] Ronald Cuming, 'Internationalizing secured financing law' in Roy Goode and Ross Cranston (eds), *Making Commercial Law* (Clarendon Press 1997) 505.
[55] Gerard McCormack, *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (Edward Elgar Publishing 2011) 81.
[56] Sami Chowdhury 'Funding and Security' in Martijn Empel (ed), *Financial Services in Europe: An Introductory Overview* (Kluwer Law International 2008) 183; Orkun Akseli, *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (Routledge 2011) 208, 227, 243; Catalin Gabriel Stanesku, *Self-Help, Private Debt Collection and the Concomitant Risks: A Comparative Law Analysis* (Springer 2015) 22; Gerard McCormack, *Secured Credit Under English and American Law* (Cambridge University Press 2004) 207; Alysse Kaplan, 'Partial Satisfaction Under the UCC' [1992] 61 Fordham L. Rev. 221; William Lawrence, William Henning., Wilson Freyermuth, *Understanding Secured Transactions* (LexisNexis 2012) 20; William Davies, 'Romalpa thirty years on – still an enigma?' [2006]4(2) Hertfordshire Law Journal 16; Douglas Baird, Security Interests Reconsidered' [1994] 80 Virginia Law Review 2262.
[57] Legislative Guide on Secured Transactions (n 34) 59; Cuming (n 54) 508; Michael Bridge, Roderick Macdonald, Ralph Simmonds, Catherine Walsh, 'Formalism, functionalism and understanding the law of secured transactions' [1999] 44 McGill Law Journal 569; Sheelagh McCracken, Personal Property Securities Legislation: Analyzing the New Lexicon' [2014] 35 Adelaide Law Review 71.
[58] Model Inter-American Law on Secured Transactions (n 34).
[59] Model Law on Secured Transactions (n 6).
[60] Bar (n 6).
[61] Jan-Hendrik M. Röver, 'The EBRD's Model Law on Secured Transactions and its Implications for an UNCITRAL Model Law on Secured Transactions' [2010] 15 (2) Unif. Law Rev. 483.

Such approach has a number of advantages. For example, the same provisions could regulate all secured devices which ensures a systematic and coherent approach to their application and interpretation.[62] The parties will not spend time and money on lawyers to learn about each type of transaction such as what advantages and disadvantages every regime provides for each party and which regime is more beneficial for both parties. Moreover, uniform regulation for all financing stakeholders will create the situation when they can attract more clients only by offering more beneficial commercial terms such as lower interest rates and better service. Consequently, competition between such creditors will facilitate economic development and easy access to credit.

The application of the pattern means that a debtor or its creditors should have a right to oblige a creditor to dispose a collateral instead the situation when the creditor just pointing out on its ownership to obtain a possession. The creditor also should account for a surplus after disposition of a collateral which will allow to the debtor's creditors to control the foreclosure procedure and increase the possibility of getting the highest price for a collateral[63]. Moreover, a collateral should be a part of the debtor's bankruptcy estate[64]. A creditor can get back an asset from the debtor's bankruptcy estate but it is obligatory to account for all payments received from the debtor, and depreciation of the goods should be taken into account.

The unitary approach was widely accepted and considered as a recommended practice for all jurisdictions[65]. Number of international acts supports idea of unitary approach for secured

[62] Legislative Guide on Secured Transactions (n 34) 56; Louise Gullifer, Jennifer Payne, *Corporate Finance Law: Principles and Policy* (Bloomsbury Publishing 2015) 351.
[63] Legislative Guide on Secured Transactions (n 34) 369.
[64] Legislative Guide on Secured Transactions (n 34) 439, 442.
[65] Anna Veneziano Attachment / Creation of a Security Interest in Horst Eidenmüller, Eva-Maria Kieninger (eds*), The Future of Secured Credit in Europe* (Walter de Gruyter 2008) 126; Marek Dubovec, 'UCC Article 9 Registration System for Latin America' [2011] 28 (1) Arizona Journal of International and Comparative Law 118; Anna Veneziano, 'The Role of Party Autonomy in the Enforcement of Secured Creditor's Rights: International Developments' [2015]

transactions[66].The critique of this approach and following recharacterization of secured devices is mainly focused on that they ignore often intentions of the parties leaving for courts to decide, for instance, whether parties concluded "true" lease or "security" lease[67]. The problem is unpredictability and impossibility to determine in advance the applicable regulation, especially it concerns transactions with ambiguous nature[68].

At the same time, it is worth to mention that integration of the unitary approach requires introduction of the purchase-money security interest concept under Section 9-324 of the UCC which gives super-priority over conflicting security rights to certain creditors and was designed to prevent security monopoly of the first creditor over all debtor's assets and encourage subsequent creditors to extend credits[69]. Such super-priority is usually granted to acquisition financing of specific goods because their use allows the debtor's business to grow[70]. As a result, in general, purchase-money security interest enhances position of financing suppliers over financiers when it is really needed. Additionally, German courts came to the same conclusion giving to finance providing by suppliers priority over finance provided by banks[71].

Thus, as could be seen from above mentioned analysis, the second approach using the unitary concept allows to address main problematic issues that arise in the process of use of title security devices which were not regulated in the first approach. Additionally, under this approach, the interests of the debtor and its unsecured creditors are ensured and are not infringed by extra powers

4 (1) Penn State Journal of Law & International Affairs 345; Alejandro M. Garro, 'The Creation of a Security Right and its Extension to Acquisition Financing Devices' [2010] 15 (2) Unif. L. Rev. 388.
[66] Parliament and Council Directive (EC) (n 19) art(s) 3,4.
[67] Gerard McCormack, 'American Private Law Writ Large? The UNCITRAL Secured Transactions Guide' [2011] 60 International and Comparative Law Quarterly 597-625.
[68] Wood (n 1) 693 – 694.
[69] Grant Gilmore, *Security Interests in Personal Property* (Little, Brown and Company 1965) 1285.
[70] Bar (n 6) art IX. - 4:102.
[71] Firm W. Bank v. Bank for W. & A., 26 BGHZ 185 (1958).

of the title security creditor. As a result, it could be concluded that the most appropriate solution for countries which stick to the first approach, is switch to the unitary approach.

2.2. Recommendations to introduce the unitary approach

In this subsection, the main focus concentrates on how countries which keep to the dualistic approach and separate traditional proprietary security and title security in the plane of regulation can resolve many emerging problems in application of title security by switching to the unitary approach.

As was mentioned in academic literature, simple borrowing of Article 9 of the UCC by jurisdictions where form of secured transaction prevails over its content such as the UK and Roman-Germanic jurisdictions will not lead to the same results as we observe in the USA[72]. To reach the same outcome, jurisdictions need to rethink and change fundamental policies[73]. One of examples of such policy is establishment of public register for secured transactions to deal with the situation of ostensible ownership which allows the title security debtor to seem an owner of a collateral and frequently dispose it to third parties who cannot know without such register whether the debtor is a real owner or not[74].

To identify which measures should be undertaken by a state to switch to the unitary approach, we will examine already familiar legislation of the Russian Federation as an example. First of all, as a common regime for all in rem securities should be the existent regime of traditional proprietary security[75]. As it was noted above, these provisions contain the most necessary norms on priority,

[72] Tibor Tajti, *Comparative secured transactions law* (Akadémiai Kiadó 2002) 215-216.
[73] ibid.
[74] ibid.
[75] Civil Code of the Russian Federation s 3 ch 23.

enforcement, and returning surplus. Second, there should be introduced a rule that title security devices specified in legislation such as purchase with retention of title clause, hire purchase and financial lease and *sui generis* devices which are aimed to secure the debtor's obligation performance by transfer or retention of title should be identified as secured transactions and should be regulated by above-specified rules on traditional proprietary security, including rules for bankruptcy proceedings.

Third, registration of in rem security transactions should be recognised as obligatory. The current regime for proprietary secured transactions does not require registration for movable property leaving it up to the parties[76]. It is necessary to mention that there are ongoing debates whether purchase with retention of title and finance lease should be registered which developed in several draft legislations which propose register such transactions[77]. Registration of secured transactions has a number of critical functions such as notification of a potential purchaser that an asset is encumbered and system to resolve disputes on priority. The idea that registration is not needed because everybody should presume that goods are acquired on credit, and the good faith doctrine could prevent abuse[78], does not work in the present case because there is no such presumption in Russia upheld on statute or precedent level, and the good faith protection is *ex-post* measure and needs long judicial proceedings which increases the burden on judicial system crucially. Forth, the unitary approach needs integration of the purchase-money security interest concept which gives super-priority over conflicting security rights to acquisition financing of specific goods enhancing

[76] Civil Code of the Russian Federation art 339.1.
[77] Draft of the Federal Law of the Russian Federation on amendment of legislation of Russian Federation in the part of creation of the registry on notifications on transactions and encumbrances in notary information system (2016); Federal Law of the Russian Federation on amendment of legislation of Russian Federation No 360 (2016).
[78] Ulrich Drobnig, 'Basic Issues of European Rules on Security in Movables', in John De Lacy (ed), *The Reform of UK Personal Property Security Law* (Routledge-Cavendish 2010) 448.

position of financing suppliers over financiers.

To demonstrate the efficiency of the unitary approach, it would be useful to review a recent case which went all way through to the Supreme Court of the Russian Federation[79]. The facts and the circumstances of the case are quite common and frequently found in practice. The plaintiff had financial problems. To resolve them, it concluded a contract with a defendant under which the plaintiff got 1,200,000 rubles from the defendant, simultaneously the plaintiff sold to the defendant its apartment. The guarantee of returning of the apartment back to the plaintiff and refund of money to the defendant was a signed preliminary contract between the parties with the condition that the defendant will sell the apartment to the plaintiff for 1,250,000 rubles in the future. Afterwards, the plaintiff was ready to repurchase the apartment, however, the defendant rejected that offer. The plaintiff filed in a court claim to recognize the purchase contract void. The defendant in return claimed to evict the plaintiff from the apartment.

Three lower courts decided in favour of the defendant considering that the plaintiff received money for the apartment. The Supreme Court did not agree with them and was of the opinion that the parties *de jure* concluded a purchase agreement instead of a secured loan agreement. The main reasons were that the price of the apartment was lower than its market price, the parties concluded the preliminary repurchase contract, and the plaintiff asks to repurchase the apartment. Taking all these facts into consideration, the Supreme Court remanded the case.

How the dispute would be resolved with the application of the unitary approach? First, it requires from a court to analyze the economic content and determine the true nature of the concluded agreement. In particular, irrespective whether the underlying contract was named as ‘sales’

[79] Decision of the Supreme Court of the Russian Federation No 5-КГ17-197 dated November 2, 2017.

contract, whether the contract in fact was a security agreement. Second, it requires the parties to register the transaction. Registration remedies the problem of ostensible ownership allowing to learn about a title security transactions and the title security debtor's rights to all interested third parties.

Third, application of the unitary approach does not allow the defendant simply keep the apartment. If the plaintiff is ready to refund, the defendant should take the money. If plaintiff does not perform its obligation, the defendant is obliged to start enforcement procedure, dispose of the collateral, take only the debt amount with some interest and the enforcement costs and give back to the plaintiff the surplus.

As we see, cases like this one demonstrate crucial necessity to rethink and revise the system of secured transactions in the Russian Federation which was the main motivation for the present research and examination of international approaches to solve this problem. Studying experience of other jurisdictions shows that there could be an adequate solution which could address many emerging problems.

Thus, application of the unitary approach facilitates resolving emerging issues and filling the gaps in legal systems where there is no uniform regulation of secured transactions. Such approach is more efficient because it allows to protect interests of debtors better and gives clear directions to courts what they need to do first hearing cases on in rem security.

Conclusion

1. General conclusions

Title security is an agreement according to which transfer of a title to a creditor or retention of title by a creditor secures an obligation of a debtor to extinguish a debt. Title security consists of different transactions such as sale with retention of title clause, hire purchase, finance leasing, repurchase agreements, and other *sui generis* agreements which use transfer or retention of title for security purposes. The nature of all mentioned transactions is concealed because being technically sales and lease agreements, they are genuinely secured transactions and could be replaced by traditional proprietary security. Their form is used to shade its secured credit essence. The reasons why they are so popular in commercial practice are that they help to overcome mandatory rules of traditional proprietary security and make access to credit possible for debtors which do not have chances to get finance through classic bank loan.

The continental European systems tend not to recognize the security nature of these transactions. Their regulation depends on the form of every transaction, i.e. sale or lease. As a result, these provisions often contrast and do not respond the issues that have frequently arisen in commercial practice such as priority, registration and enforcement. Such pattern frequently leads to infringement of debtors' and its unsecured creditors' rights because the applicable regulation simply does not contain rules on returning a surplus after discharging the title security creditor claims.

After confrontation with various challenges and gaps caused by insufficient regulation of title security, the US regulation (Article 9 of the UCC) following by several other jurisdictions and a couple of international documents like the Draft Common Frame of Reference and the

UNCITRAL Legislative Guide on Secured Transactions promote the idea that the content of secured transaction should prevail over its form. Since traditional proprietary security and title security are intended to reach the same economic objectives, concealing the real nature of title security transactions should not prevent application of provisions which provide fair balance between the contract parties and third parties.

2. Conclusions applicable to the Russian Federation

Nowadays, title security in Russia is governed mainly by provisions on sale or lease contracts in the Civil Code depending on the type of contract. These provisions are laconic and give no grounds for their perception and interpretation as proprietary securities. As a result, such regulation does not reflect their real legal nature and leads to their misunderstanding by courts and parties. At the same time, the Civil Code's provisions on traditional proprietary security contain all necessary details on key issues as priority, enforcement and allocation of proceeds. For example, a secured creditor should share a part of proceeds after sale of a collateral with other creditors to maintain the balance between interests of secured and unsecured creditors. However, these rules are not applicable to title security transactions because title security is conceptually distinct.

Implementation of the unitary approach means that there should be provided a uniform regime for all in rem securities. The rules on traditional proprietary security should be taken as a basis because they contain all significant norms on priority, enforcement, returning surplus which allows to cover many problems arising in practice. Applying the unitary approach, all secured transactions should be qualified according to their economic content, not form. It means that courts should analyse the terms of an agreement, and if they are aimed to secure the debtor's monetary obligation, they should be identified as secured transactions.

Devices like sale agreement with retention of title clause, hire purchase and financial lease are definitely qualified under this notion because, according to these contracts, the debtor virtually receives credit for acquisition of a certain asset, and, in the case of default of the debtor, the creditor discharges its claim from the value of that asset following a special detailed procedure of foreclosure requiring the creditor to share proceeds with the debtor and its other creditors. Applying the unitary approach, all these transactions should be regulated by rules on traditional proprietary security, including rules on priority, enforcement and bankruptcy proceedings. Additionally, unitary approach requires introduction of registration for all proprietary security transactions which allows to notify all third parties about such transactions and purchase-money security interest which gives super-priority for supplier-creditors which provide funding for acquisition of certain assets.

Transformation of the governing approach in regulation of title security will not only protect interests of the title security debtor and its other creditors, but also provide easier access to credit for debtors at lower cost and risks thanks to the prospective uniform regulation. On one hand, by eliminating the risks corollary to the necessity of learning about not one but more security regimes, and, on the other hand, by creating a level playing field for all classes of creditors that wish to extend financing on the strength of movable collateral.

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