C ▪ E ▪ A ▪ L

Center for the Economic Analysis of Law

Washington, DC

Nicaragua:
Draft Law on Security Interests in Personal Property and Commentary

Nuria de la Peña
Heywood W. Fleisig
Robert Muguillo

February 1998

Discussion draft only, please do not cite without the author's permission.

1201 Pennsylvania Avenue, NW, Suite 300
Washington, DC 20004
202.646.1787 phone
202.666.1789 fax

Nicaragua:

Draft Law on Security Interests in Personal Property and Commentary*

Nuria de la Peña
Heywood W. Fleisig
Roberto Muguillo

February 1998

* The views and interpretations expressed in this paper are those of the authors and do not necessarily represent the views and policies of the Center for the Economic Analysis of Law (CEAL).

Nuria de la Peña is Research Associate and Director of Operations in Latin America at the Center for the Economic Analysis of Law (CEAL), Heywood Fleisig is the Director of Research at CEAL, and Roberto Muguillo is research associate at CEAL.

The authors thank Violeta Rosenthal, Rodrigo Chaves, Ronald C.C. Cuming, Alejandro Garro, Lance Girton, Alfonso Ortega, Graciela Rodriguez-Ferrand, John A. Spanogle, Peter Winship for extensive and helpful advice and comment, and the students that worked on this translation under the supervision of Professor Peter Winship: Gonzalo Zorilla, Fernando Ariel, Daniel Deaton and Carlos Valdes. Many Nicaraguans have generously given their time to explain their perspectives on these problems. The authors thank them for their help. Any errors, however, entirely remain the responsibility of the authors.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

DRAFT LAW ON SECURITY INTERESTS IN PERSONAL PROPERTY AND COMMENTARY

INDEX

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

Draft Law on Security Interests in Personal Property and Commentary

STATEMENT OF PURPOSES

Background[1]:

In Nicaragua, several problems in the legal framework for securing credit with personal property limits access to credit in the agricultural sector. These problems involve the creation, registration, and enforcement of security interests in personal property. For example, personal property that might secure loans includes inventory, equipment, livestock and accounts receivable. To create a security interest in personal property--typically the pledge--is expensive. Moreover, many types of property cannot be used as collateral under the law of pledge (e.g., crops to be harvested in more than 18 months and accounts receivable not represented

by negotiable instruments), or may not be used as collateral independently of real property (e.g., future crops). The laws do not require registers that provide a suitable inexpensive public notice way to find out if there are prior security interests in the same collateral. Finally, the rules that regulate the repossession and sale of collateral following default have established a costly process. This process takes so long that a greater part of the collateral depreciates before it can be repossessed and sold to pay loans that are past due. For very small loans, moreover, the cost of enforcement is disproportionately high.

These problems in Nicaragua's legal framework limit access to credit in agriculture. First, farmers and agricultural intermediaries in the agricultural credit chain do not have the means to secure loans with the physical capital they presently have--capital in the form of personal property. Second, sellers of personal property cannot sell this property on credit using the property sold as collateral. Third, this defective framework for secured transactions makes it difficult for lenders in the formal sector to provide refinancing through the natural conduits of rural credit, especially to the buyers of agricultural products and the distributors and providers of equipment and inputs used in agriculture: the lenders do not have a legal means of creating a security interest in the fluctuating portfolios of accounts receivable or chattel paper held by these rural commercial intermediaries. This limited access to credit is one of the key obstacles to rural development.

Nicaragua: Access to credit and the framework for secured transactions

The preparatory study for this draft law included interviews with producers of coffee, fruit, peanuts, and shrimp; with manufacturers; with distributors of construction and agricultural machinery; with merchants who deal in agricultural products; with sellers of fertilizers and pesticides; with regulators working for the Superintendent of Banks; with bank lawyers; with officials of the registry; with managers of small and large institutional

---

[1] This background explanation summarizes the work described in the report "Nicaragua: How Problems in the Framework for Secured Transactions Limit Access to Credit" by Heywood W. Fleisig and Nuria de la PeZa (Center for the Economic Analysis of Law, Washington, D.C., 1997) and the studies for the first four preliminary drafts of the Law on Secured Transactions (Center for the Economic Analysis of Law, Washington, D.C., 1998).

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

banks; and with finance companies and retail businesses. All the businesses interviewed were either lenders or borrowers of credit in the chain of credit in Nicaragua. In each case, however, the credit available was typically limited to the value of the real property that could be offered as collateral, using a mortgage or holding title to real property. For some commodities, additional credit is available by pledging notes secured by the commodities held in a warehouse; for a few lenders a pledge of new automobiles is used. In general, however, personal property does not have much value as collateral.

The credit available today does not satisfy the credit needs of Nicaraguan producers. For example, it is the commercial practice in the distribution of coffee for the buyer of coffee to buy from the final producer, who is typically a small land holder operating a small plot. Over the years the buyer will establish a working relationship with his producers and will extend credit for the purchase of fertilizers, fungicides, and pesticides. The amount of credit offered will depend on the confidence the lender has in the capacity of the producer to repay the entire loan. There is no security interest. This system of unsecured credit depends on the personal knowledge that the coffee buyer has of his producers. This kind of system produces trillions of dollars of loans in North America. But in contrast to the lenders in North America, the buyer of coffee in Nicaragua has limited ability to borrow using personal property as collateral; the amount the buyer, in turn, can offer his producers is limited by the buyer's own difficulties in obtaining credit. In the North American case, the North American buyer can use his portfolio of receivables to secure loans from lenders in the formal sector, such as a bank. The Nicaraguan buyer cannot do this. In Nicaragua, access to credit is limited because of restrictions on the creation of security interests found in the framework for security interests in personal property. The buyer might obtain a mortgage of real property. But, instead of land, the buyer has personal property: tangible personal property--trucks, fluctuating inventory of processed or unprocessed coffee--and intangible personal property--accounts receivable owed by the small producers or owed by coffee exporters in the cities. In Nicaragua, all the personal property must be financed from the buyer's own capital; none of this personal property has value as collateral for a loan in a way that would permit him to expand his operations and offer more credit to his producers.

In the interviews, some lenders gave the appearance of using their equipment, inventories and accounts receivable as collateral. But this was an illusion. Instead, the banks gave the companies one line of credit based on the value of property owned by them--real property. Later financing secured by personal property is usually deducted from the line of credit. No additional credit is given to companies that increase their accounts receivable by expanding sales or doubling their inventory by more efficient production of agricultural products. For many interviewees, their disposable credit was limited to the amount of the value of their land and they were not given any credit secured by personal property. Apparently few kinds of property other than real property are "truly" accepted as collateral. This limitation is an almost fatal constraint. It means that as rural demand for credit grows for personal property--such as equipment, inventory, pesticides, herbicides, and seed--credit will not grow to accommodate this demand. In each case, the legal and institutional limits on the use of personal property as collateral for loans limit the access to credit in profitable transactions and developing agricultural businesses.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

These limitations in the use of personal property as collateral for loans do not arise from macro-economic problems or from high intermediation spread, but from problems in the Nicaraguan framework for credit secured by personal property which makes personal property very risky collateral.

The Economic Importance of the Secured Transactions Problem

The problems with the present framework for secured credit have a high economic cost for Nicaragua. They limit the direct participation of banks in the financing of personal property. They retard the development of other sources of financing. These problems limit access to credit for those who do not own land. This limited access to credit lowers the gross domestic product of Nicaragua. It diminishes opportunities for all Nicaraguans, especially for farmers and small businesses.

The Practical Importance and the Economic Value of Collateral

As a practical matter, collateral is important. In industrial countries lenders will typically lend more at a lower interest rate when collateral is offered. The amounts lent and the rates charged will vary depending on the different types of security. For example, members of the employees' credit union of the World Bank or International Monetary Fund may obtain credit equivalent to six months of their salary without collateral (by their signature only), the equivalent of two years of their salary for loans secured by a security interest in personal property such as cars or recreational vehicles, and the equivalent of four years of their salary for loans secured by real property (e.g., a mortgage). Moreover, the more collateral offered by a member, the lower the interest rate or the longer the period of payment offered by the credit union. For the first two classes of loan the debtor does not have to own real property. It should be noted that this example involves the same person, the same institution, execution of the same loan, and the same loan committee. The single variable is the collateral.

Not so in Nicaragua. As in many other Latin American countries, to lend in Nicaragua follows a different pattern. For most loans made by institutions in the formal sector, the lenders require a mortgage or the personal guarantee of some owner of real property. When a pledge of personal property represents the only collateral for the loan, the loan is invariably granted to a borrower who also owns of real property, or to a borrower whose guarantor owns real property. This second type of secured transaction is like a "potential mortgage"--partially functioning to demonstrate the capital and creditworthiness of the borrower and his guarantor; partially raising the prospect that the lender may recover from the real property in case of default. What is missing in Nicaragua, as compared to more advanced secured credit systems in industrial countries, are substantial loans secured in the final analysis only by a security interest in personal property.

The limitations on acceptable security may represent an important restriction on credit because the final magnitude of credit secured by personal property could be enormous. In the United States, for example, loans secured by a security interest in personal property amount to almost 40% of total credit and total credit is more than double the gross domestic product. In Nicaragua, loans secured by personal property extend no

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

further than loans secured by new automobiles or by warehouse receipts for some commodities. This also limits total credit, which amounts only to about 50% of gross domestic product.

The Economic Roots of the Importance of Security

Neither interest rate adjustments nor equity financing can replace the need for a system in which lenders are able to take a security interest in collateral to secure loans. The economic foundations of this premise are briefly examined here.

The Rationing of Credit and Asymmetric Information

First, adjustments to interest rates cannot be substituted for a secured transaction. Why? Why is it not possible for lenders to charge higher interest rates to higher-risk borrowers, correlating the risk with the expected returned? In such a world, borrowers without collateral would pay a higher interest rate, but would nevertheless have access to credit. Following this line of reasoning, a framework for secured transactions would explain why borrowers with poor collateral have to pay higher interest rates than borrowers with good collateral.

However this hypothesis does not explain what we observe in Nicaragua--there, the borrowers with poor collateral appear totally incapable of obtaining loans. Why? Because the credit markets cannot ration completely loans by changes in interest rates.

The key is found in asymmetric information. The borrower knows his intentions and his true situation; the lender has to guess about them. Given that the lender can never be totally sure of the buyer's willingness or ability to pay, the borrower's agreement to pay a high interest rate is ambiguous. Thus, a borrower may have a project with high returns. But this borrower may also intend not to pay the interest or the loan. In a world with such uncertainty, the collateral can demonstrate at moderate cost the borrower's belief in his promise to pay.

Second, equity financing cannot be a complete substitute for secured lending. Debt and equity financing are interchangeable on the margin. Therefore, it could be argued that a viable project not financed by debt could be financed by equity investments. If that were the case, a poor legal framework for security interests in personal property would only displace financing by debt with equity capital. There would not be an overall economic cost arising from a defective system of secured transactions: either debt or equity capital will eventually finance all profitable projects. A defective secured transaction system would only reduce the relative share of debt financing.

For industrial economies, in which businesses have easy recourse to the issue of stock, the problem of not being able to borrow is less serious. However, even in countries such as the United States, where equity financing is perhaps the most developed in the world, this form of financing represents only a small fraction of total new investment. In Nicaragua, however, the stock market offers an even less adequate substitute for secured loans. Only a few big corporations in Nicaragua are able to issue stock because of the high costs of underwriting public issues. When stock markets do not function well and equity

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

must be internally financed, to say that debt and equity financing are interchangeable on the margin will be small comfort for the majority of businesses.

These problems in the Nicaraguan framework for security interests in personal property have been observed in other countries, such as Argentina, Mexico, Uruguay, Bolivia, Honduras and El Salvador, which share with Nicaragua a civil law tradition. But these problems are not confined to these countries. Bangladesh, India and Pakistan are common law countries with similar problems because of an inadequate legal framework for credit secured by security interests in personal property.

The economic consequences

Personal property represents approximately half of capital goods and about two-thirds of net commercial investments. Even so, because it is very difficult in Nicaragua to obtain loans secured by personal property without additional security in real property, abundant and cheap credit for those who are not owners of real property is limited. Businesses that should expand at the rate that they increase their inventories and accounts receivable find themselves with very little credit to operate efficiently. As is explained in the report "Nicaragua: How Problems in the Framework for Secured Transactions Limit Access to Credit", this problem does not have its roots in the economy but in problems with laws and registers necessary for loans secured by personal property. Property that in the United States and Canada easily secures loans and can be bought on credit is not accepted in Nicaragua as collateral: to create security interests in personal property--typically by pledge--is legally difficult, costly and risky; its register is slow, expensive and uncertain; repossession of collateral and its sale takes too much time and is costly in relation to the value and depreciation of the collateral. This draft law addresses each of these problems.

Scope of Application and Creation of Security Interests (Chapters I & II)

To be economically useful, everyone should be able to grant a security interest in any property, present or future, fixed or fluctuating, identifiable or not, things or rights, unless a clear principle of public policy otherwise provides. Modern economic transactions are complex, requiring many different parties; requiring also a floating security interest that conforms with the process of production. When the law artificially restricts these transactions, farmers and businesses find it difficult to create security agreements that satisfy the law and that provide assurance that they will be enforceable.

The draft law expands the kinds of property that may be used as collateral to include present or future property, identifiable or floating property, personal property affixed or not to real property, accounts receivable and any other patrimonial right. The draft law eliminates many requirements and expenses for the creation of a security interest in personal property, such as the need to prove ownership of the goods, and certifications and other verifications of the signatures on the security agreement. Instead of these requirements, the draft law permits lenders to take whatever steps they think appropriate to verify ownership or signatures.

Finally, a primary objective of the draft law has been to separate the legal framework for credit secured by personal property from credit secured by real property in order to

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

increase access to credit without having to address the more difficult and extensive issues of land reform. For example, the draft permits security interests in future crops, independent of who owns or holds the land on which the crop is grown.

Perfection (Chapter III)

Whatever the value of property used as collateral, a lender can only determine this value when he knows the value of any prior security interest in the same collateral. When it is expensive or difficult to acquire this information, lenders do not finance by taking a security interest in this property; when the register itself is uncertain, or when unregistered security interests have priority over registered security interests, lenders will not lend against personal property collateral. Registration plays an important role in determining priority of security interests in collateral. The value to society of the register does not arise from the verification of the security agreement by the state. Public verification offers little additional value for users of the register. The important thing is that there is a clear ranking of security interests and that there is an efficient register with full access to the registered information.

The draft law proposes a system that, in general, gives priority based on priority in time of the filing of a financing statement in an electronic database. There would be a single electronic archive of security interests for all of Nicaragua, but it would provide plenty of public access from anywhere. The draft also contemplates that an authorized consortium of private people would be entrusted with maintaining the database and, at the same time, would compete to provide services to the electronic archive. The draft authorizes the issuance of regulations to establish this system as well as the design work found in this study.

Enforcement (Chapter IV)

Collateral has no value for lenders if it is not possible to repossess the collateral and sell it quickly and inexpensively in case of default. Costly delays in enforcement for periods of between two weeks and one or three years do not permit loans to be effectively secured by personal property. A lot of personal property has a short economic life: inventory, cattle, future crops; this property will have no value as collateral when enforcement procedures are lengthy and costly. Even goods, such as industrial and agricultural equipment, will lose a great part of their value during the period of enforcement. Instead of selling this equipment with a down payment of ten or twenty percent, as is common in the United States and Canada, lenders require 50 or 75 percent. For lenders to accept these goods as collateral, the procedures for repossession should be quick, cheap and certain. A marginal solution will have a marginal impact. For example, even if procedures improve so that repossession and sale of collateral take six months, instead of one year, the impact will be very small. No rational lender will accept inventory or thirty-day accounts if the legal framework provides for enforcement in six months or disproportionately high enforcement costs in relation with the amount of the loan.

To solve this problem, this draft law permits the parties to agree on how the loan will be recovered in case of default. In the absence of such an agreement, the draft gives the secured party the option to bring judicial proceedings, and/or to repossess and sell the

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

collateral without judicial intervention. This latter option is available as long as force, violence or intimidation is not used, the collateral is sold in accordance with applicable usages and customs, and the profits of the sale are distributed in accordance with the requirements established by this draft. The draft penalizes severely those secured parties who violate these conditions.

In this respect, the draft has followed the most successful solutions in the United States and Canada. In these countries, in both their common law and civil law jurisdictions, this problem regarding the cost and delays in enforcement of security interests in personal property has been resolved by expanding the possibilities for private repossession and sale in such a way that it removes from the courts a great number of cases involving the enforcement of security interests in personal property. In contrast, in common law jurisdictions such as Pakistan, Bangladesh and India, where these changes have not been made, security interests in personal property are extremely limited.

The principal changes introduced by the draft law

- ***The draft replaces the pledge with security interests in personal property***

The concept of the security interest in personal property is more comprehensive than that of the pledge: This results from the difficulty of expanding the concept of pledge (a type of security interest) to cover property not fully identified, or accounts receivable not represented by instruments. The concept of security interest permits one to expand the types of property that can serve as collateral. Expanding the property which can serve as collateral is the key to expanded access to credit.

- ***The draft law follows the model of the most advanced laws for personal property financing laws (UCC Art. 9 and PPSAs, the personal property secured transactions laws in the U.S. and Canada respectively), as well as adaptations made in the civil law jurisdictions of Quebec and Louisiana and the preliminary drafts of personal property security interest laws in Argentina and Bolivia.***

That the fundamental changes made in this draft are inspired by the most advanced comparable legislation does not imply that this draft is a "copy" of UCC Article 9, nor that the draft intends to introduce Anglo-Saxon concepts or legal elements that are incompatible with the roman law tradition of Nicaragua's legal system. The idea is neither to copy nor to impose foreign legal models, but simply to make an effort to adopt those fundamental ideas that inspire a regime of secured transactions adapted to the need to make credit more accessible and less costly. This "adoption" of legal policies inevitably implies an "adaptation" of the legal framework to the traditions and realities of Nicaragua.

Harmony of Nicaraguan legal rules with the rules of other countries will facilitate the international financing of equipment and accounts receivable, as well as foreign trade generally. The draft law also conforms with the draft international conventions prepared by UNIDROIT and UNCITRAL on security interests in mobile equipment and accounts receivable in international transactions, respectively. The principles and concepts that inspire these international conventions are similar to those that inspire this draft. It is to be hoped, therefore, that adoption of this draft law will harmonize Nicaraguan legislation with

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

the international regulation of security interests in personal property, and will thereby serve as a pioneering model for the regulation of financing mechanisms in the regional integration of Central America.

- ***The draft law establishes a single system of priority among secured parties***

The possibility that a lender will not have priority in the collection of payment from the debtor is a serious risk to lenders. This possibility arises because of the common problem of "hidden creditors." The draft law establishes a single mandatory system of priorities among secured parties. This system provides that the first secured party to record a notice of the security interest will have the first right to be paid with the proceeds of the sale of the collateral following default.

This priority rule is applicable to any creditor who has a security interest, and also to any creditor who, by contract, has an interest in the debtor's property that secures payment of an obligation. This avoids hidden creditors who, for example, enter into a conditional sale or similar contract[2] instead of a security agreement. This feature of the draft law is key to lowering the risk of hidden creditors. For example, a debtor who acquires property by a lease with an option to purchase will not be able to give the appearance that he is the owner of the goods free to use them as collateral with another lender. Any other lender will know that this property of the debtor is subject to a finance lease because the draft law requires that notice of the lease be recorded in the database in order for the lease to have priority over other creditors and, for that reason, financial lessors will record these notices in the database. The draft assures them that, by filing, their claim has priority over any other creditor. To the extent new leasing business and even newer credit operations develop they will not introduce the risk of hidden creditors: whenever, in whatever way, and with whatever type of contract a security interest is created, the rules of priority and enforcement of this draft law will govern. In most cases, these rules condition priority on recording a public notice.

- ***The same collateral may be used to secure not only the security interest of a first secured party but also security interests of junior secured parties***

The object of this rule is to permit greater economic use of property as collateral for loans. The current system of pledge requires the first secured party to consent in order that the same property may serve as collateral for a second secured party. The draft law does not require this consent. Second and later secured parties are permitted without the need for the first secured party's consent.

The requirement that the first secured party must consent limits access to credit because the first secured party has no incentive to consent to an increase of the debtor's total debt. In such a case, for example, if a producer buys a machine on credit for $10,000, for which he had paid $9,000 and owes $1,000, the producer will find it difficult to use the same

---

[2] The Civil Code prohibits conditional sales contracts for personal property, but not for real property, and this draft law covers some real property such as heavy equipment affixed to land (real property by destination)

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

machine as collateral for another loan because he will need the consent of the first secured party.

It has been said that not requiring the first secured party's consent diminishes that creditor's rights in the collateral, and that the debtor should be penalized for creating further security interests in property already subject to a security interest. This is erroneous. The important thing is to permit the free circulation of property in order that the debtor may maximize his economic potential, and at the same time secure for the secured party the possibility of recovering the property and collecting payment first if the debtor defaults. This is the objective of this provision.

We should note that although the security interest is liquidated the first secured party always collects its debt first: the draft law permits junior secured parties, but it clearly establishes that the first secured party must be fully satisfied before any proceeds of the sale of the collateral is given to the junior secured parties in the order of their interests. Although there has been no specific analysis of this topic it would seem that the economic benefit of permitting greater use of personal property as collateral would exceed the risk to the junior secured parties of a premature liquidation of the collateral for default.

- ***The draft law changes the system of registration of the security agreement (registration of the contract of pledge) to filing public notice in a electronic archive with a centralized database for the whole country***

The draft law provides that secured parties have priority to payment in the order in which they file their notices in the electronic archive. This system is different from a register of pledges in that instead of registering the security agreement a notice which contains minimum information about the security agreement of the creditor is filed in the database. To implement this notice system, the draft provides a form that should be completed by the secured party and signed by the debtor. The information required by the form includes the names of the debtor and the secured party, their respective addresses, and the description of the collateral; i.e., only information strictly necessary to know if the property is subject to the security interests of other secured parties. This information goes to a database that automatically records the day, hour, minute and second. This system is called "Notice Filing" ("Archivo de avisos"). The system allows ample public access to the database in order to search and copy the recorded information, while at the same time preserving the privacy of the transaction. Lenders that need more information can obtain this information from the debtor. They can, for example, ask the debtor for a copy of the contracts or for authorization to obtain the information directly from an existing secured party. Any lender will be in a position to obtain more information: otherwise the loan will not be granted.

The draft law also contemplates that the government will authorize private entities to operate and maintain the database. As has already been stated, this alternative will be studied, and it would be premature to say anything more than that there is a possibility that certain functions may be transferred to private entities, especially those activities which require advanced automation and which special businesses can operate better than can the State. However, the idea is not to replace government functions within the State's

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

competence as the exclusive provider of public services. Instead, the idea is to permit certain functions related to computer systems and to the reception, maintenance and distribution of information to be given to enterprises specialized in these matters.

It should be observed that the electronic filing system for notices is not covered by the same registration principles that have been traditionally governed the recording of the transfer of ownership of real property or mortgages. It is a new type of entry, that, in order to avoid confusion, should be referred to as a simple notice ("aviso") to third parties that a person could have a security interest in a specific good or type of property. In the event that information not found in the notice is needed, the debtor may ask for more information (e.g., which property serves as collateral, what is the outstanding balance of the secured obligation, etc.), and the secured party must answer.

- ***Secured parties can repossess and sell the collateral***

Finally, as said earlier, the draft law permits the parties to agree how the secured party can repossess and sell the collateral in case of default. The secured party is authorized to take the collateral, provided that he does not use force or violence; and to sell it as provided in the agreement or, in the absence of an agreement, in accordance with custom and trade usage. The draft penalizes secured parties who violate these established standards. Under these rules, secured parties are expected to recover their debts within a few days.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

CHAPTER ONE: GENERAL PROVISIONS

ARTICLE 1 (Scope of application)

I. This law applies to all transactions intended to secure the performance of an obligation by creation of a security interest in property and rights of a patrimonial kind as defined in this law, except for property and rights expressly excluded. To have the effects attributed to a security interest by this law, the security interest must be created, perfected, and enforced in accordance with the provisions of this law.

II. The following transactions are within the scope of this law:

(a) All transfers of receivables;

(b) Sales with a right to repurchase, sales with a right to rescind, leases with an option to purchase, trusts, and all other transactions which, without regard to their form or denomination, are intended to guarantee the performance of an obligation affecting property and rights defined in this law;

(c) To have the effect attributed to them by this law, the transactions covered by paragraphs (a) and (b) shall be created, perfected, and enforced in accordance with the provisions of this law and other applicable legal rules.

(d) The provisions of this law apply to those legal acts notwithstanding that the contract is denominated "industrial pledge" (*prenda industrial*), "agricultural pledge" (*prenda agraria*), "commercial pledge" (*prenda comercial*) or similar term.

III. References in existing laws to civil, commercial, agrarian or industrial pledge or to any other security interest in personal property which is governed by this law shall be deemed to be references to security interests governed by this law.

Concordance: Civil Code, Arts. 596, 608, 2676, 2685.

ARTICLE 2 (Personal property- Definition)

I. The following property and rights fall within the scope of Art. 1 of this law:

(a) All property which is not real property as defined in Book II, Title I of the Civil Code;

(b) All personal or real property governed by paragraph III of this Article; and

(c) All rights and actions with respect to the property covered by subparagraphs (a) and (b).

II. By way of example, the following is a non-exclusive list of property and rights which may be subject to a security interest:

(a) Property held as inventory, whether or not the property is fungible;

(b) Credit balances in checking accounts, savings accounts, or time deposits in banking or financial institutions;

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

(c) Documents of title such as warehouse receipts, bills of lading, and similar documents; the right to rents of real property;
(d) Shares or partnership interests in companies;
(e) The rights to exploit natural resources and to operate public services;
(f) The rights arising from patents, trade marks, and all other kinds of rights arising from intellectual, industrial or commercial property;
(g) Accounts receivable, and portfolios of accounts receivable;
(h) All negotiable instruments, including instruments secured by a mortgage or financial trust of real property; and
(i) All the personal property of a debtor, including existing property and the transformation of this property, future property acquired after the creation of a security interest, accounts receivable, or any combination of these categories of property.

III. The following property is also within the scope of Art. 1 of this law:
(a) Personal and real property permanently attached to other property for an economic or ornamental purpose, if the attached property remains identifiable notwithstanding being accessory and if the attached property is capable of removal or extraction; and
(b) All personal and real property which is affixed to real property and which is capable of removal or extraction. Unless a restrictive declaration provides otherwise, the following are included: standing timber, the harvest of agricultural products, and machinery affixed to the ground.

IV. For the purposes of this law, the terms "collateral" (*bien en garantía*) and "property or rights" (*bienes o derechos*) refer to all the property or rights defined in the preceding paragraphs.

Concordance: Civil Code, Arts. 601, 607.

Source

Civil Code of Quebec (Canada), Arts. 2666 & 2668; Uniform Commercial Code (United States) § 9-102 (hereinafter "UCC").

ARTICLE 3 (Exclusions)

I. This law does not apply to:
(a) a mortgage of real property not included within the definition of Article 2 III.
(b) a mortgage of vessels and aircraft.

Commentary

The present draft law provides special rules regulating security interests in movable property and in rights. This legal framework replaces the framework established by the Civil Code, the Commercial Code and other special legal provisions on pledge.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

Security interests:

It is taken for granted that the security interest can be created in property (things with economic value, such as equipment or cattle) and in any legal right (such as receivables or copyright). When this draft law refers to all rights, it includes personal rights and property rights, and excludes rights regarding legal status. The draft starts from the civil law concept of "security interest" and focuses on unifying and modifying all legislation that refers to security interests and to legal transactions which affect personal property, as defined in this law, securing an obligation to pay.

Repeals:

This draft repeals the laws of pledge and any other rules on registration currently in force. It also repeals and modifies every rule contrary to the provisions of the draft. (See the final articles on repeal.)

The draft permits parties who so wish to enter into a security agreement and call it a "pledge" or "mortgage". However, if the security agreement covers property or rights governed by this law, this law will apply no matter what the parties have called the transaction.

Contracts of sale with the right to repurchase and contracts that may be rescinded under certain conditions are mentioned because even though the Civil Code prohibits these contracts as to personal property (see Civil Code, Arts. 2684 and 2689) they may be used for real property, and much real property is included within the scope of this draft law.

Hybrid security interests:

There are doctrinal debates about whether certain contracts are personal or real.[3] In this respect the draft law considers that the rules on the creation, perfection, and enforcement of the security interests in personal property are applicable to all legal transactions that create a lien on the debtor's property to secure payment of a debt. For example, the draft is applicable to the financial lease of personal property, without entering into the debate about whether or not the financial lease is a security interest. Originally the section said "every contract that affects …". However, given that there may exist unilateral legal acts (e.g., in business organizations or in trusts) that affect property securing the payment of a debt, it was decided to refer them as all legal transactions.

Transfer of receivables:

These articles allow the use of a receivable or a portfolio of receivables as collateral for a loan. A security interest in a portfolio of receivables should be recorded in the electronic archive of security interests. The rules that allow the security interest in property

[3] See, e.g., "Institutos de Naturaleza Controvertida" in Beatríz Areaán, *Curso de Derechos Reales, Privilegios, y Derechos de Retencion*, Ch. 6 (Abeledo-Perrot, February, 1992).

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

described in general terms permit the security interest to float over the portfolio (Article 16), and will permit the receivables in the portfolio to change without the need to execute a new security agreement or to file a new notice of the security interest every time that a new receivable is created.

Although not all transfers of receivables are intended to secure an obligation, it is necessary to apply to all transfers the rules of this draft law [Article 1 II(a)] as well as those in the Civil Code. This is because it is difficult to establish a standard for distinguishing a transfer of a receivable by way of security from an outright transfer. This draft law's rules on perfection and enforcement must apply to all transfers of receivables [Article 1 II(a)]. This prevents a debtor who borrows against a portfolio of receivables by an assignment for security and who remains as agent for collection from subsequently assigning the receivables for security another time or granting a security interest under this law without giving public notice of the transfer. If recording a notice were not necessary, others potential lenders would not be able to learn that the receivables had been assigned for security.

This form of financing in this draft law has advantages over the factoring and discount of negotiable instruments. By creating a security interest in a portfolio of accounts receivable: (i) the borrower (i.e., the creditor of the accounts in the portfolio) may continue to have a direct relation with his clients without the need to have them pay at a different place, since the receivables do not have to be transferred to the lender; (ii) the lender does not have to notify the account debtors, thus saving that expense; (iii) the borrower may replace the receivables in the portfolio because the security interest is a floating charge on the accounts receivable.

When the receivables in the portfolio are negotiable instruments this advantage is not available because a security interest in a portfolio of negotiable instruments should be perfected by endorsement of each instrument [Article 24 II (a)].

Real property:

The draft law applies to personal property that is accessory to real property (Civil Code, Art. 600, 601). This inclusion permits, for example, the financing of a heavy machine without having to pay the high costs of a mortgage on the entire property where it is to be located. A security interest in real property by destination which is recorded in the electronic archive of security interests has priority over a mortgage on the property which is subsequently recorded in the Register of Property where the property is located.

A subsection was added which specifically covers all property that is affixed naturally or artificially to real property and that is capable of removal or extraction [Article 2 III(b)] in order to make clear that a security interest may be granted in "standing timber" and "crops".

Security agreements:

Contracts secured by security interests in personal or real property can themselves be subject to a security interest. This permits, for example, a car distributor to finance his inventory by delivering the negotiable instruments and the security agreements which the

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

purchasers from the distributor have delivered to him.

Exclusions:

To Article 3 may be added a specific reference to any right to develop natural resources which one may wish to exclude from the scope of this law.

This draft law does not apply to any real property excluded. For example, this draft will not apply to a mortgage of a farm.

This draft does not address the public policy prohibitions in Nicaraguan laws that limit the legal rights of persons to dispose of property or interests. Thus, if the broader legal framework prohibits a person from disposing of property or interests, no lender will logically accept that property or interest as collateral. For example, if the law prohibits the disposal of community property or rights to natural resources, such person would not be able to grant a security interest in that property or right under this law.

Limitations on the disposition of property rights have great economic impact, because they impede trade in this property and diminish their value. For that reason, only a principle of fundamental public policy justifies such restrictions. If it is otherwise, the problem goes beyond considerations of this draft law because limitations on the transfer of property not only affects its utility as collateral but also its usefulness in trade generally.

Given that public policy prohibiting the disposition of certain property or interests may change in the future, it is key that this draft law allow all property to be used as collateral. Thus, if at some future time, a restriction on the transfer of a particular kind of property is repealed, then this draft will not need to be amended and that property may be used as collateral.

This draft law will apply in the following context:

Loans secured by a security interest:

On personal property and some real property by destination

- By transfer of the property to the secured party or a bailee (the secured party or a third party takes possession of the collateral)
- By transfer of the property (the debtor retains possession of the collateral)

On rights

- By possession of the instrument:

  Ex.: endorsement for security of negotiable instrument

- By filing a financing statement:

  Ex.: assignment of claims or accounts receivable, a security interest in a portfolio of claims, a security interest in a portfolio of security agreements covering personal or real property (e.g., a security

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

interest in a portfolio of mortgages); a security interest in copyrights, patents and marks.

The draft law will not apply to:

Loans secured by a security interest

On real property not included in Article 2 III

Ex.: mortgage, trust, or financing lease of land, buildings, or vessels.

Unsecured loans

Ex.: loans on a signature alone, guaranty, groups with joint and several liability (*except all assignments of claims or accounts receivable*).

ARTICLE 4 (Security interest- Definition)

I. The security interest governed by this law is a property right which secures the performance of obligations that can be expressed in money.

II. Every kind of obligation may be secured by a security interest governed by this law, whether the obligation is present or future, conditional or unconditional, divisible or indivisible, for a fixed or variable amount, or whether it is an obligation to give, to do or not to do.

III. A security interest grants to the secured party the right to possess and retain the collateral after the debtor's default.

IV. In case of default, a secured party with a security interest perfected in accordance with this law has the power to satisfy the debt with the sale of the collateral and the right to recover the collateral and its proceeds in the hands of third parties for the purpose of such sale.

V. The obligation secured by a security interest includes interest, expenses, and judicial costs, unless the parties provide otherwise.

Commentary

Obligations:

The future obligations that may arise between the secured party and debtor, whether conditional or unconditional, may be secured by a security interest. The security agreement may or may not state the estimated amount of the conditional obligation [see Article 13 I]

Terminology:

This draft chooses to use the term "security interest" instead of "chattel mortgage" or "pledge". To the extent the term "security interest" may be understood to include a security interest in real property, which this law does not regulate, the adjectival phrase "personal

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

property" may be used (see Diccionario de la Real Academia Española, pp. 979 & 999, and Civil Code, Art. 608) to make clear that the security interest to which this law refers only covers property or rights that are preponderantly not real property.

This draft law governs all the rights of security interests in the property covered by the draft, including the pledge and the mortgage of this property, as the pledge and the mortgage are considered as types of security interests. The decision to use the concept of "security interest" in this draft rests on the desire to expand the property which may be used as collateral beyond the property that may be pledged or mortgaged under existing legislation.

This draft law also gives the security interest characteristics that differ from those traditionally attributed to the pledge and the mortgage. For example, this draft provides that a security interest may be created in property that is acquired in the future, over chattel paper, or over a fluctuating inventory of non-fungible items. The terms "pledge" or "mortgage", which are types of security interests, may suggest characteristics that are more restrictive than desired.

Statutory and judicial liens:

The security interest to which this law refers is a lien on property which arises only from a voluntary legal transaction. Liens which the law places on property by virtue of judicial judgments or awards are also liens on property but to distinguish them they should be identified as "privileges" or "judicial liens" and not as a "security interest".

ARTICLE 5 (Proceeds- Definition)

I. In the context of this law, "proceeds" of collateral includes any benefit, property, or reward received upon the sale, exchange, collection, indemnification or other form of management or disposition of the collateral; any fruits of the collateral are also deemed to be proceeds.

II. The amount payable by virtue of insurance covering the risk of accident, loss, or damage to collateral is deemed to be proceeds of the collateral, provided that the insurance payment is owed to the parties to the security agreement or to their assignees.

III. Proceeds are "cash proceeds" if they are money, checks, deposits in bank accounts, and the like; otherwise the proceeds are "non-cash proceeds".

Source

UCC § 9-306(1).

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

CHAPTER TWO: CREATION OF SECURITY INTERESTS

ARTICLE 6 (Creation of a security interest: effects and transfer)

I. A security interest is effective as between the parties from the moment the debtor and creditor sign a security agreement, unless the parties expressly agree on another time.

II. If the collateral is automobiles, aircraft, vessels or boats, the security agreement requires the participation and consent of the owner of the collateral.

III. In all other cases, the consent of the owner of the collateral is not required at the time the security interest is created. Nevertheless, the security interest is not created and does not affect the property rights of the owner of the collateral unless and until the owner has consented.

Commentary

Signature

The debtor creating a security interest must sign the security agreement.

Consent of the owner of the collateral

This draft law withdraws the requirement that the owner of the collateral participate and consent to the use of the property as collateral. Instead, for the financing of inventory, it is provided that the security interest never affects the ownership of the owner of the collateral. There is no requirement, therefore, that the owner participate in the security agreement (a requirement that would, in any event, increase the risk the agreement might be found a nullity), and it is left to the lender's judgment whether or not to ask for the owner's consent. The possibility does not arise that some who only has possession (e.g., a bailee) may grant a security interest in the property affecting the owner's rights because, as provided in this article, the security interest cannot affect the owner's rights as owner without his consent. In practice, creditors who take a security interest in bailed property will require the owner's consent. For example, a security interest can be granted in a financing lease without the consent of the owner of the property. In such a case, the lessee can grant a security interest in his rights under the lease agreement without the consent of the owner. If the lessor wants to limit this possibility, he can simply take the first security interest in the lessee's rights under the lease.

This article does not subordinate the rights of the lessor to third parties. On the contrary, the lessor has the status of a secured party if he takes the first security interest. In any event, the property may not be distrained by the debtor's other creditors because the lessor is the owner. Nor may the debtor grant a security interest in the property to other creditors, because he is not the owner of the property and the security interest cannot affect the rights of the owner of the collateral, who, in this example, is the lessor (see Art. 7).

The lessee-debtor may only secure the "rights" that derive from the lease agreement,

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

not the property itself, because he is not the owner. As such, the debtor may grant a security interest over a right in the return of money paid under the lease agreement. As stated earlier, in this case, if the lessor wishes to prevent this he can take a security interest in these lease payments. At present, there is no way to prevent this; another creditor, for example, may attach or obtain a general restraining order on the property of a debtor-lessee. The present pledge laws do not permit pledging rights of collection not represented by a negotiable instrument. Consequently, under the present pledge laws the lessor is afforded less protection. This draft law adds the possibility of securing any right of collection with a security interest and such security interest would have priority over any subsequent secured party with a judicial lien.

ARTICLE 7 (Ownership of collateral)

I. A security interest may be created in property subject to special terms of sale and to after-acquired property as provided in Article 9 (After-acquired collateral) and in accordance with the requirements that the owner consent as provided by Article 6 (Creation of a security interest: effects and transfer).

ARTICLE 8 (Status of secured party or debtor)

I. For the purposes of this law, any physical or legal person, whether a citizen or a foreigner, may be a debtor or secured party in a secured transaction securing any kind of obligation.

ARTICLE 9 (After-acquired collateral)

I. A security interest may be created before the debtor has title, possession, or rights in the collateral, provided that the security agreement refers to this collateral. In such a case, the security interest relates back to the time of perfection, even if that time is before the debtor has title, possession, or rights in the collateral.

II. The security interest may be created before the secured party transfers the funds giving rise to the debt or otherwise performs, but the security interest is conditional on the existence of the principal obligation. In this case, the security interest relates back to the time of perfection, even if this time is before the transfer of funds or other performance.

Commentary

Future property and obligations:

This rule, and the one that follows, permits the financing of business and agricultural inventories, and the financing of working capital. Businesses with inventory for sale or manufacture need to be able to use as collateral property that they acquire or produce in the future. The financing of working capital needs flexibility to secure lines of credit and so they need clear rules under which the secured party does not lose his priority with respect to

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

future transfers of funds from the line of credit.

The pledge, except for the case of future harvests, gives priority to the secured party only from the moment in which a condition is satisfied, for example from the moment the debtor becomes owner of the collateral or from the moment the loan is disbursed. In this draft, although the creation of the security interest becomes enforceable upon satisfaction of the condition, the security interest's priority is determined by the date of its perfection even though this is before satisfaction of the condition--i.e., before the debtor becomes the owner or before the secured debt arises.

Economic benefits:

Security agreements that cover after-acquired property and future obligations provide great economic benefits for the financing of lines of credit and inventory because of low costs and the secured party's greater security with respect to priorities. For example, they permit a textile business to secure a loan with products that are being packed in another place, even though the business does not have possession of the inventory and would not be considered the "owner" of the inventory, and therefore would not be capable of granting a security interest in those goods under present pledge law. These problems will not exist under this article.

Furthermore, the rules on the use of after-acquired property as collateral have great economic importance because one can secure obligations with properties without stipulating the exact nature of the property or the moment of its existence. These possibilities reduce transaction costs: when “future” collateral comes into existence, such as by harvest or production, there is no need to amend the security agreement by rewriting, correcting, or reregistering. Such a security agreement can cover property such as automobiles and clothes, as well as inventory of raw materials, unfinished goods, or property that is transformed.

In countries where the financing of inventory is flexible and inexpensive, the financing of inventory typically includes a clause under which the security interest over the inventory also covers the accounts receivable and the debtor’s future inventory.

Larceny and fraud:

There is no conflict between this article and the crime of theft or fraud when the parties act pursuant to an agreement legitimated by this draft law because the debtor is not granting a security interest in property “as if it were from his own” when the security agreement stipulates that the property will be acquired in the future.

The MAZEAUD brothers say that “the security interest results from the encumbrance of certain property of the debtor to secure an obligation: sometimes all the debtor's goods or all his moveable or immovable property, present or future (general security); sometimes by specified property of the debtor (special security)."

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

ARTICLE 10 (Fruits and products of collateral; universality of property)

I. The security interest may be created, perfected and enforced in natural, industrial, and civil fruits or proceeds of the collateral.

II. The security interest may be created in a general class (universality) of property.

Concordance:

Civil Code, Arts. 622-626; Law of Personal Property Secured Transactions (hereinafter "LGR"), Arts. 2 & 5.

ARTICLE 11 (Collateral not owned by the debtor)

When the owner of the collateral and the debtor are not the same person, the term "debtor" includes, depending on the context, the owner of the collateral.

Source:

UCC § 9-105(1)(d).

Commentary

The assimilation of the owner of the collateral to the debtor of the secured obligation has no other purpose than to ensure that the owner has some of the rights that are granted to the debtor of the secured obligation. The owner of the collateral is only responsible *in rem*, while the debtor of the secured obligation is liable to the extent of all his property.

ARTICLE 12 (Security agreement)

I. A security agreement is an agreement in writing to create a security interest in property or rights for the benefit of a specified creditor, and to grant to the creditor the rights of retention, enforcement, and priority, recognized by this and other laws.

II. Whether or not it is in a separate agreement or part of the principal contract, a security agreement gives rise to an interest that is always accessory to, and subordinate to, an obligation. That the security agreement is accessory does not affect the relative priority of the security interest perfected in accordance with Article 9 (After-acquired collateral) and the provisions of Chapter Three (Perfection of Security Interests).

III. The term "writing" includes any mode of communication that preserves a record of the information contained therein and is capable of being reproduced in tangible form.

Source:

UNIDROIT Principles for International Commercial Contracts, Art. 10.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

ARTICLE 13 (Content of security agreement)

I. The security agreement may, but need not, indicate the estimated amount of the obligation secured.
II. The security agreement shall describe the collateral generically or by a specific description.
III. The debtor shall sign the security agreement.
IV. The security agreement need not be notarized; it shall express the intent of the parties to create a security interest in personal property and rights.

Source:

UCC § 9-105(l); Commercial Code of Uruguay, Art. 741 (pledge); John A. Spanogle, *Proposed Polish Charges Act*, 1991, Art. 2(1).

Commentary

High transactions costs:

This article tries to reduce the cost of creating security agreements. Many loans cannot pay for the public document cost or the cost of certification of signatures by a notary--these requirements increase transaction costs and the costs of refinancing. This draft law gives lenders contractual freedom to require those measures which they consider necessary, such as certification of the signatures by a notary. In other countries it is common for banks to impose strict requirements for signatures on loan contracts and security agreements.

In the United States, for example, banking laws and secured transactions legislation allow banks to adopt all the precautions needed with total freedom. There were laws and regulations that required the banks to require a government identity number for borrowers, but these requirements were struck down as unconstitutional. But banks in the United States themselves establish very strict regulations. For example, some regulations prohibit the debtor who is not physically present in the bank from signing the papers and the signing must take place in the presence of the loan officer with whom the client is dealing. Sometimes they require the presence of a notary for the act of signature and its certification, they prohibit contracts from being signed by proxy, or they require that the contract be completed on a specific form. In many banks, the bank's managers are prohibited from opening a bank account without first calling the telephone company and verifying that the telephone number the client provided is accurate. The regulations of the bank supervisors ensure that the bank complies with its own internal regulations and, if it fails to do so, the bank is subject to sanctions.

This article, by permitting but not requiring the security agreement to indicate the estimated amount of the secured obligation does not contradict article 2447 of the Civil Code. The Civil Code requires a contract to state an "object" certain, not a "price" certain.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

Documentation:

In practice, three documents usually accompany the secured loan: (i) the loan contract, which includes such details as the sums and payments required by the parties; (ii) the security agreement, which should be completed in accordance with the requirements set out in Article 13; and (iii) the financing statement signed by the debtor, and the information in this statement is all that has to be registered in the Archive for security interests.

ARTICLE 14 (Creation of successive security interests in the same collateral)

I. While the security agreement remains in effect, the debtor may create a second and later security interest in the same collateral without the authorization of the secured party.

II. Terms are invalid if they make payable on demand all or part of the secured principal obligation when the debtor grants a second security interest in the same collateral or if they require the debtor to pay any other type of fee or charge. However, a contract term that requires payment of the principal obligation if the debtor transfers the collateral is valid.

III. While the security agreement remains in effect and as long as the secured obligation is adequately and reasonably fulfilled, the debtor may possess and use the collateral owned by him and the proceeds of that property as long as the debtor is adequately and reasonably satisfying the secured obligation.

Commentary

When other security interests may be created in the same property, access to credit is improved. The object of this principle is to permit greater economic use of the property given as security. The present system requires that the first secured party give its consent before the debtor may subsequently grant a security interest in the same property to a new secured party. But this limits the possibility of obtaining credit because the first secured party has no incentive to consent to a major indebtedness on the part of the debtor. For example, if a manufacturer bought equipment with a credit of 10,000 dollars, and has already paid 9,000 dollars, that manufacturer could not use that same equipment as collateral for another loan.

It is true that the second secured party increases the first secured party's risk that the collateral will be sold because the debtor may default on the second secured obligation. But it should be remembered that the first secured party is always paid first. This draft permits second, third and additional secured parties, but it also establishes that the first secured party is to be paid before other secured parties. Likewise, it appears that the economic benefit of permitting greater use of movable capital as security outweighs the additional risk.

In compliance:

The provision “as long as the debtor is adequately and reasonably satisfying the

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

secured obligation" is included to lessen the possibility, following default, the debtor may lawfully dispose of the collateral.

Sale or industrialization:

As long as the debtor is complying with the secured obligation (paragraph III), the secured party's authorization is not necessary to sell the collateral or to continue the economic industrialization, because the security interest continues over the proceeds of such a disposition.

Economic Justification:

This draft law is inspired by the wish to maximize the economic utility of collateral, principally by permitting a security interest in fluctuating inventory.

Although the debtor may sell the collateral, the secured party retains the following powers: a) its security interest continues in the "proceeds" the debtor receives (e.g., on default, direct deduction from bank accounts of money received on disposition of collateral [see Art. 51]); b) when a generic description of the collateral is used, its security interest is protected by the other property that has been exchanged for the original collateral without altering the secured party's priority; c) similarly, its security interest continues in property acquired by the debtor after the creation of the security interest; and d) when there is due-on-sale clause, the secured party can require payment of the entire loan.

ARTICLE 15 (Secured parties)

I. Every physical or legal person, whether a citizen or a foreigner and whether or not domiciled in Nicaragua, may be a secured party or a debtor in a secured transaction.

Commentary

Status of secured parties:

This article appears redundant, but it has been thought desirable to include it because much legislation limits the use of security interests to certain debtors and to certain institutional creditors (such as banks). One of the objectives of this draft law is to increase the participation of lenders of credit in order to encourage healthy competition between them so that they are better situated to give credit. The draft also does not limit who may be debtors in order to promote access to credit by all persons. This legal policy is not unaware of potential abuses, but simply opts to leave the courts to handle these problems in particular cases, with the power to strike down a credit contract given within an abusive and exploitative context. Consequently, this draft allows every kind of person to create a security interest, whether or not they are physical or legal persons, merchants or financial institutions. The intended objective is to facilitate the development of credit based on

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

movable property by all the economic entities throughout the credit chain.

Civil and commercial credits:

In addition, this draft does not distinguish between the type of operation that is secured, or the commercial status of the debtor or secured party.

The need to include both consumer and commercial credit suggests introducing this draft as a special law, rather than as a chapter in the Civil Code or the Commercial Code, the scope of which is limited. Moreover, the importance of a special law also stands out because it may be adapted and modernized by a better and more rapid legislative technique to take into account the experience which is garnered from application of the present law.

ARTICLE 16 (Property: description, fixtures)

I. Collateral may be described specifically or in general terms.

II. A security interest may be created in property defined in Article 2 III (a) and (b) of this law. This security interest is distinct from any encumbrance on personal property or the real property to which it is affixed. Chapter III (Perfection) of this law determines the relative priority of this security interest in relation to third parties, and, in particular, its relative priority with respect to creditors secured by an interest in the real property.

Concordance: Article 2 III (a) & (b).

Commentary

Identification:

The problem of identifying the collateral could be important when there are different creditors; in order to solve this the draft law provides the following: 1) it allows a general description and provides a mechanism for subsequent identification (see Art. 21), and 2) it lets the parties decide on whether to include a specific description in the security agreement, since nothing prohibits the parties from identifying the collateral specifically if they so wish. In the latter case, lenders should remember that it would be more difficult to recover if they cannot find collateral, because they cannot take possession of other property. Many lenders probably will opt – in the same security agreement – for a specific description over certain property and for a general description over the personal property of the debtor. Others, through a generic description of a type of property and a generic description of all other personal property of the debtor, as happens in the United States and Canada. For example, with credit secured by cattle in the United States and Canada, the majority of lenders include as collateral a general description “cattle” and “all present or future personal property of the debtor.”

Moreover, a security interest could be created in any right, like receivables, in such a

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

way that the receivables in a portfolio could change as some are liquidated and others fall within the collateral description.

To the general description of the collateral Article 9 adds the possibility of collateral to be acquired in the future. This future acquisition does not affect the priority of the secured party, which is determined as of the time the security interest is perfected.

Floating security interest:

The security interest floats when it covers a "universality" of property or property described in general terms, such as the inventory of a business or livestock, without the need to identify every individual item and whether or not the items are fungible.

Examples of general descriptions are: “all of the accounts receivable of Quimex S.A.”; “all of the property belonging to the restaurant El Cahalan, including existing property and property that can be used or mixed, aggregated or acquired, or substituted for any of the present property”; “all the cattle of Mr. Jose Debtor”; “all of the water pumps installed on the land at route 1, kilometer 23”; "all farming products found on the property located in X”; “all funds in any bank account in the name of Jose Debtor”; “all equipment, parts, or tools located in the unit 43 of Avenida Cruz 2525”; “the shares of Jose Debtor in the co-operative La Hermosura.”

ARTICLE 17 (Continuity of security interest)

I. The security interest continues to exist as an enforceable security interest in collateral notwithstanding the disposition of the collateral in any manner by the debtor or the owner, unless the secured party has authorized the disposition.

II. If the debtor disposes of the collateral without the authorization of the secured party, the secured party may, at its option, enforce the security interest in collateral traced into the hands of a third person or in the proceeds received from the disposition of the collateral, or both.

III. Unless otherwise agreed, the security interest continues to be enforceable in proceeds of the disposition of the collateral collected by the debtor and which remain in the debtor's possession or control, provided that the proceeds are identifiable as proceeds of the disposition of the original collateral.

Source:

UCC § 9-306(1); John Spanogle, *Proposed Polish Charges Act*, Art. 2(5).

Commentary

The security interest always continues in the proceeds of the collateral even if the security agreement does not so provide. The explanation is that it is preferable not to burden the secured party with duties or proofs which would make it difficult to exercise his legitimate rights as a secured party.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

If, for example, the debtor sells a tractor that is subject to a security interest and the debtor deposits the money in the bank, the money is collateral. If the money is used to purchase something, then the purchased item is collateral. If the item is transformed into another item it will also be collateral. There does not exist a limitation on the continuity of collateral; from the original property given as collateral to its proceeds and the proceeds from the proceeds. The secured party maintains his relative priority and, upon default on the secured obligation, he may repossess and sell these proceeds. For instance, it may notify the bank and force the bank to retain the money that constitutes the proceeds of the collateral.

ARTICLE 18 (Presumption with respect to proceeds and the continuity of the security interest in personal and real property)

I. Any property received by the debtor on the disposition of the collateral is presumed to be the result of the disposition or transfer of the original collateral or the proceeds of the collateral, unless the debtor proves otherwise.

II. The security interest continues in proceeds even though they change from personal property to real property, and vice versa.

Concordance:

LGR, Article 5.

ARTICLE 19 (Irrelevance of title or possession of collateral)

I. The provisions of this law with respect to the rights, obligations and remedies of the parties apply without regard to whether the secured party or the debtor has title or possession of the collateral.

Source:

UCC § 9-202.

Concordance:

LGR, Art. 1.

Commentary

There are agreements that may or may not be considered security agreements, like the financial lease or the trust with personal property, but they are within the scope of this draft law. For instance, in a financial lease, the creditor (lessor) and not the debtor (lessee) remains the owner of the leased asset. In a conditional sale, the seller remains the owner of the goods sold until the final payment of the price. But if the intention is to secure payment for the good leased or sold, the fact that the lessor or the seller is the owner of the good does not give him priority over a secured party with a security interest in the same collateral. The relative priority of the lessor and the seller, as well as the rank of other secured parties,

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

is governed by the priority rules of this draft law, whether or not independently of the fact that the secured party retains ownership of the collateral.

ARTICLE 20 (Goods deposited in public warehouses)

I. The holders of warehouse receipts issued by a public warehouse may create a security interest in the receipts.

II. A security interest in goods represented by a warehouse receipt issued by a public warehouse may be created only by taking a security interest in the warehouse receipt pursuant to the provisions of this law.

ARTICLE 21 (Right of the debtor to a statement of account)

I. The debtor may ask the secured party, at any time, to declare the amount owed on the obligation secured. To do so, the debtor shall send a certified communication to the secured party with a signed statement of the estimated amount. The secured party shall correct or approve this statement and certify his response to the debtor.

II. The secured party shall respond to the request of the debtor within fourteen (14) calendar days after the secured party receives the request. If the secured party does not respond, the amount stated in the debtor's communication shall be considered valid.

III. When the security interest covers all the personal property of a particular type, the secured party shall designate in its response to the debtor the type of personal property covered by the security interest, without the need to approve or state in detail the collateral.

Source:

UCC § 9-208.

ARTICLE 22 (Termination of the security interest)

I. The security interest may only be terminated by an express release of the secured party which specifically refers to the discharge of the secured obligation and the release of the security interest.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

CHAPTER THREE: PERFECTION OF SECURITY INTERESTS

ARTICLE 23 (Effect of a security interest and priority)

I. Security interests created pursuant to the present law and every legal transaction referred to in Article 1, paragraph II, have effect against third parties from the time the security interests are perfected in accordance with this law.

II. The secured party has a preferential right to collect from the property or rights serving as collateral and their proceeds as determined by the time, order, and rank of the perfection of the security interest in accordance with this law.

ARTICLE 24 (Perfection)

I. As a general rule and to effect publicity effective against third parties and for enforcement of preferential rights, every security interest in personal property shall be perfected by entry of a "Financing Statement" in an Electronic Archive of Security Interests in Personal Property (hereinafter "Archive of Security Interests" or "Archive").

II. The following cases are exceptions to the previous paragraph:

(a) A security interest created in negotiable instruments which is perfected by means of an endorsement;

(b) In accordance with the preceding subparagraph, a security interest in a negotiable warehouse receipt issued by a public warehouse may be perfected only by an endorsement on the back of the certificate with a phrase such as "valor en garantía." The parties may indicate in the body of the certificate the amount of the debt secured, the interest agreed upon, and the date of maturity.

(c) A security interest in nonnegotiable instruments may be perfected only by filing a financing statement in the Archive of Security Interests.

(d) A security interest in a obligation security agreement may be perfected only by a filing in the Archive of Security Interests.

(e) Public warehouses that issue warehouse receipts shall, in order to make the receipts effective as to third persons, record the issue in the Archive of Security Interests by filing a financing statement.

(f) A secured party whose secured obligation does not exceed 300 pesos Centroamericanos may also perfect the security interest by taking possession of the collateral.

(g) A security interest in a bank account and certificates of deposit may only be perfected by filing a financing statement in the Archive of Security Interests.

Commentary

Possession:

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

This article decreases the number of secured transactions that may be perfected by possession. Perfection by possession may be effected by simulating possession of the property on the part of the secured party, for example, by renting the debtor's place of business.

Warehouse receipts:

The perfection of a security interest in warehouse receipts in public warehouses presents a problem of the "divisibility" of the collateral.

To require perfection by filing a financing statement has the advantage of permitting the same property to be used as collateral securing obligations to more than one creditor, since the debtor would be able to create a security interest in the same warehouse receipt several times. This would permit the debtor to divide the collateral, allowing the same warehouse receipt to secure multiple and competitive financing at the same time. Nevertheless, perfection by filing has the disadvantage of making the transaction more expensive by adding the cost of filing the "financing statement" (on the other hand, this cost will be minimal if the filing system is efficient). Under the option followed here, the security interest is perfected by an endorsement to the secured party on the warehouse receipt. The endorsement avoids the cost of filing a "financing statement" and strengthens the practice of a note issued against warehoused property. Nevertheless, perfection by endorsement will not allow the divisibility of the collateral, because the warehouse receipt can be endorsed and transferred to only one creditor at a time. In other words, if the warehouse receipt represents goods worth $ 100,000, the receipt may be endorsed to secure a loan of $ 60,000, but the debtor will not be able to use the same warehouse receipt to secure other loans with the remaining value (i.e., $ 40,000). Which is to say that $ 40,000 will not be used to secure any transaction – the collateral will be non-divisible. Article 484 of the Commercial Code nevertheless allows the holder of a warehouse receipt to ask that the property deposited in a public warehouse be divided and to require the warehouse to issue several warehouse receipts in exchange for the single original receipt. This article is modified in this draft, but the possibility of dividing the deposited property and having separate receipts issued continues.

On the other hand, this article requires that a notice be filed to record the issue of all warehouse receipts (subparagraph (e)). This requirement is key to avoiding the risk that the financing transaction is secured by an interest in the warehouse receipt with the authorization of the warehouse rather than the debtor. In these cases, the debtor may appear to be the possessor of the property covered by the warehouse receipt, and may give another security interest in the property, thereby making it difficult for other lenders to know that the property is covered by a warehouse receipt. The information required in the filed form is minimal and does not include the value of the merchandise.

Subparagraph (d) adds only a clarification. Because the "security agreement" given as security is one of the contracts regulated by this draft law, no other disposition is necessary (see Arts. 1 & 2 of this draft), a "financing statement" should be filed as provided in paragraph I.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

In subparagraph (g), consideration was given at first to regulating the perfection of certificates of deposit of money in bank accounts by endorsement of the certificate. But such an option would introduce the risk that there might be a duplicate of the same certificate of deposit if the depositor fraudulently alleged that it had been lost. To establish a system of perfection by endorsement it would also be necessary to require the recording of the issue of every certificate of deposit and afterwards permit transfer by endorsement. This would be more cumbersome for financial institutions because they would have to register every certificate of deposit issued even though the certificates are not used as collateral. Thus, it has been decided to require the filing of a “financing statement" only when the certificate is subject to a security interest.

Economic benefits:

A factor that reduces the inherent risk of using security interests over personal property and that consequently increases its value as collateral results from giving lenders certainty with respect to their priority in case of default. Perfection by possession could lead to conflict with perfection by filing the “financing statement” contemplated by this draft law. To avoid this problem, the draft provides that the secured party may perfect by taking possession where there are loans of minimal amounts, here limited to 300 Central American pesos, that is, the equivalent of 3,000 córdobas. Other standards could also be used to maintain this level of monetary value such as, for example, a reference to the minimum wage.

The possibility of perfection by possession will allow small lenders, like pawn shops, to operate without the need to file, but a financing statement is required for large loans. This strategy focuses on the prevention of a double system of perfection (filing and possession), that could defeat the purpose of minimizing the risk. The exception is applied in terms of the amount of the credit extended because this amount is easier to establish than the value of the collateral.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

ARTICLE 25 (Priority of the secured party)

I. The secured party must perfect its security interest to have priority over any other security interest and over the rights of any other secured party or person who subsequently acquires the collateral.

II. Between a security interest that is perfected and a security interest that is not perfected, the perfected security interest has priority.

III. Between a security interest in inventory and a security interest in specific items of that inventory, the security interest that was perfected first has priority. However, a security interest retained by the seller of the collateral or granted to a creditor whose loan made it possible to acquire the collateral has priority over an earlier security interest created in the inventory, if he has perfected his security interest within 10 days of the sale.

IV. The rank of a security interest perfected by endorsement of a warehouse receipt is determined as of the moment when the warehouse that issued the receipt files notice of the issue in the Archive of Security Interests.

V. All negotiable instruments may be secured with a security interest. In this case, an endorsee has priority over the collateral from the moment the security interest is perfected.

Commentary

All negotiable instruments may be secured. The term "negotiable instrument" in paragraph V includes checks, bonds and debentures. Moreover, it includes any foreign instrument considered an instrument by the law under which the instrument was created.

In addition, an instrument may serve as collateral for another obligation.

ARTICLE 26 (Priority between a security interest in fixtures or accessions and a mortgage)

I. When a security interest in fixtures is recorded in the Archive of Security Interests, the financing statement should also include the description and address, or the cadastral nomenclature, of the real property to which the fixtures are attached.

II. Notice of a security interest in accessories to real property shall be entered in the Archive of Security Interests to be effective against third parties, even though a mortgage of real property and its accessories has been registered in the Property Register.

III. Between a security interest in accessories to real property and any other encumbrance on the real property that includes its accessories, the security interest in accessories has priority if notice of the security interest has been entered in the Archive of Security Interests before the encumbrance arose.

ARTICLE 27 (Privileges created by law)

I. A creditor with a privilege has priority over every secured party whose security interest was perfected after the entry of the privilege in the Archive of Security

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

Interests, or, when the privilege depends on the taking of possession, while the creditor with a privilege has possession of the property.

Source:

UCC § 9-201 (Louisiana).

Commentary

Creditors with a privilege must register their privilege electronically in the Archive of Security Interests in order to have priority from that moment against creditors with a security interest. If his privilege depends on the taking of possession, the creditor with a privilege must take possession of the property prior to the perfection of the security interest in order to have priority over the secured party.

ARTICLE 28 (Judicial liens and other court orders)

I. A creditor with a judicial lien has priority over secured parties whose security interest was perfected after the judicial lien on the collateral or after the entry of the lien in the Archive of Security Interests.

ARTICLE 29 (Rights of a buyer in good faith)

I. When the obligation is secured with a security interest in inventory, the security interest is not effective against a buyer of the collateral who acquires the property in good faith and in the ordinary course in a sale to the public by the seller.

Source:

UCC § 9-307(1).

Commentary

This is done in order not to limit sales on credit by businesses that sell to the public, or to impose on buyers the burden of consulting the Archive of security interests each time they acquire goods from a business that sells to the public. A businesses that sells to the public may be either a retail or a wholesale business.

When a business has given a security interest in floating collateral (without precise identification of each item in its inventory), the business sells the property free from the security interest of his creditor. This is because the security interest of a secured party with a floating security interest continues in the accounts receivable or the new merchandise acquired by the business, but as there is no precise identification of the merchandise in the inventory, the security interest does not continue in the goods sold by the business to the public.

ARTICLE 30 (Rights and obligations of the secured party and third parties in possession of the

collateral)

I. When the collateral is in the secured creditor's possession, the secured creditor or a third party has the rights and obligations of a bailee as provided in the Civil Code.

II. The secured party holds the fruits or interest produced by the collateral for the account of the debtor. Unless otherwise agreed, the fruits or interest are applied first to the reasonable expenses to preserve the property, then to the interest, and then to reduce the amount of the secured obligation.

III. The secured party or third party is obligated as a bailee to return the collateral to its owner the moment the secured obligation is discharged. They are liable for the damages caused in case of the loss or deterioration, or unjustified delay in returning the collateral, or if they unjustly refuse to accept payment of the principal obligation and the resulting termination of the security interest.

Commentary

"Damages " recoverable under paragraph III include both actual damages and lost profits.

ARTICLE 31 (Transfer of a security interest by assignment)

I. All security interests are transferable by an assignment of the security agreement. The assignment may be evidenced by an instrument that is not notarized and, to be effective against third persons, must be recorded in the Archive of Security Interests.

ARTICLE 32 (Lapse of perfection)

I. A security interest or encumbrance recorded in the Archive retains its priority as long as the principal obligation is not discharged.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

CHAPTER FOUR: CHAPTER FOUR: ELECTRONIC ARCHIVE OF SECURITY INTERESTS IN PERSONAL PROPERTY

ARTICLE 33 (Electronic archive of security interests: concept)

I. Within sixty (60) days after the publication of this law, the Executive shall, in accordance with regulations issued under the law, organize and begin operation of an Electronic Archive of Security Interests in Personal Property (hereinafter "Archive" or "Archive of Security Interests").

II. The regulations shall cover the following matters relative to the organization and operation of the Archive:

(a) Systems and procedures for the recording of security interests in centralized databases or by networks throughout the country.

(b) Systems and procedures for information for users of the service and the competent authorities.

(c) Civil liability in relation to the damages caused to users of the services.

(d) Types of tortious or criminal conduct that give rise to application of relevant sanctions.

III. By a public auction conducted in accordance with the law governing such auctions, the Executive may entrust the administration and technical operation of the Archive to persons, businesses, special commercial companies, or non-profit civil associations which satisfy the requirements established by regulations.

Commentary

The term "Electronic Archive of securities interests" has been chosen to suggest the fundamental differences between the publicity system for security interests in personal property created by this draft law and the traditional system of entries in a register to transfer ownership, create mortgages and changes in rights in real property. In the first place, the publicity system created by this draft is totally autonomous, in the sense that it is not based on the usual books or the usual registration folios typical of registration systems for real property. Thus the reference to an "electronic" system which is based on a computerized database. In the second place, it involves a publicity system based on a simple "archive" of the information necessary to "notify" third parties or potential creditors that the debtor has, or may have, granted a security interest in certain types of property. Thus the reference to a mere archive of information, which is a database limited to receiving information submitted by the secured party without the responsible office of the Archive having to judge whether the information is legally sufficient.

Repeals:

The present legal provisions on public registers of pledges or of liens on movable property will not apply to this Archive of security interests. These regulations will be repealed and will be replaced by new regulations established in conformity with this draft.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

ARTICLE 34 (Manager)

I. The authorized physical or legal persons shall designate a Manager of the Electronic Archive (hereinafter "Manager"), who shall be a person who is morally sound and sufficiently solvent to satisfy the liabilities which may be incurred. The physical or legal persons which have been authorized shall be vicariously liable for the acts of the Manager.

ARTICLE 35 (Supervision)

I. The governmental authority which the Executive has designated shall supervise the operators of the Archive to ensure compliance with the dispositions of this law and shall inspect the functioning of the Archive when appropriate. The governmental authority may immediately revoke the authority of an authorized person when the institution learns that the authorized person has not complied with this law and regulations issued hereunder.

II. The governmental authority shall investigate any complaint of noncompliance with this law and regulations issued hereunder by the Manager of the Archive. It has the power to confiscate all the records of the Archive, to assume control, and to audit the office in question for malfeasance or repeated serious faults in the functioning of the office.

ARTICLE 36 (Operation)

I. The governing body designated by the Executive shall organize and operate the Archive of Security Interests on the bases outlined in the following paragraphs.

II. Recording a security interest in the Archive shall not be conditioned on the presentation of documents which attest to the payment of taxes on collateral, on the obligation secured, or taxes of any other kind, nor shall it be conditioned on the verification of ownership of the collateral. There shall be a reasonable fee to record a security interest. The fee shall be in an amount sufficient to pay for the materials used and for a return to the private operators as prescribed in tariffs established by regulation.

III. If the functioning of the various offices permits, the different files should be connected so that the Archive operates like a single system, with general interlinked databases of a kind that permit one to search or to record electronically and to make entries in that office effective immediately.

IV. The managers of the Archive shall be responsible for recording the information, and any interested persons may request information by accessing directly the databases of the Archive. The Archive does not certify or warrant the information recorded unless this is customary.

V. The Archive is public and shall be open to any person for consultation during the hours established by the designated supervising authority. Consultation shall be without limit, charge, or any other requirement. The Archive may provide access to the public by any means established by regulations in order to allow the public to

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

obtain and copy the information in the Archive. The Archive shall also permit access to this information from off the premises.

VI. Entries in the Archive shall be made on forms prescribed by this law, which shall create a document suitable for filing in the Archive and for having an effect against third persons.

VII. Regulations shall require the use of internationally-established technical standards for the Archive's database.

Commentary

The use of personal property as collateral to secure loans requires an inexpensive, trustworthy and flexible system, and therefore the principles of publicity that govern are necessarily different from those that govern the registration of real property. Access of the public to the information in the Archive achieves this objective in different ways: It allows access to the archived information by more than one provider of services, thus assisting creditors to verify directly information which is key for them; and public access makes public the content of the archive and consequently decreases the opportunities for fraud by modifying the filed information.

ARTICLE 37 (Receipt and recording of documents in the electronic archive)

I. A petitioner who wishes to file a document in which is the possible existence of a security interest is recorded shall present or send to the Archive, by any means prescribed by regulation, a financing statement which shall be completed in the form established by this law. This form of financing statement (hereinafter "financing statement") does not have to be certified or the signatures authenticated.

II. Upon receiving the financing statement, the Manager shall record the date and the hour the form was received and shall record the information on the form in the database by manual or electronic means.

III. Within 24 hours of recording a financing statement, every secured party is obligated to send an authentic copy of the form to the debtor.

IV. The Archive is authorized, pursuant to regulations establishing the Archive, to permit any person to enter himself the contents of a Notice signed by the debtor in the database of the Archive.

ARTICLE 38 (Form of financing statement)

I. A financing statement in the form set out below satisfies the requirements for perfection under this law.

FINANCING STATEMENT

YOU ARE GRANTING A SECURITY INTEREST IN THE FOLLOWING GOODS TO SECURE REPAYMENT OF A LOAN

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

Name of the debtor: **Name of the secured party:**
Legal address: **Legal address:**
Special address: **Special address:**
Collateral:
Description of real property if the collateral is a fixture:
Signature of the debtor(s):

Commentary

The security agreement differs from the financing statement notice in that the latter only requires information strictly necessary to determine if the debtor has property subject to a security interest.

ARTICLE 39 (Address noted in archival entry)

I. In order to determine the rights and obligations of the parties with respect to third parties, the parties are deemed to have the special address indicated in the financing statement. Likewise, all notices sent in accordance with the security agreement to the addresses in the financing statement are valid and binding. Any party may modify the address by notifying the other party directly at the special address and by notifying the Archives. The Archive shall not cancel the previous addresses.

II. For the purposes of this law, the address of a legal person shall only be the address indicated in the written agreement creating the legal person.

ARTICLE 40 (Cancellation)

The entry in the Archive shall be canceled when the secured party expressly requests the cancellation or when a judicial order directs cancellation.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

CHAPTER FIVE: ENFORCEMENT OF SECURITY INTERESTS

ARTICLE 41 (General provisions)

I. Upon default of the secured obligation, the secured party may choose to initiate judicial proceedings in accordance with the provisions of the Code of Civil Procedure or to enforce the security interest in accordance with the provisions of this chapter, or both.

II. If the secured party initiates judicial proceedings, the security agreement may be enforced pursuant to article 1690 of the Code of Civil Procedure without further ado.

Concordance:

Civil Code, art. 1859; Civil Procedure Code, Art. 1684.

ARTICLE 42 (Repossession upon default)

I. Upon default of the secured obligation, the secured party has the right to satisfy the amount owed from the collateral. To this end the secured party has the power to take possession of the collateral or its proceeds by peaceful means without the need for a judicial summons, judicial assistance, or the need to pay a fee, tariff, or any tax.

II. When exercising this power to repossess, the secured party shall not breach the peace, use physical force or intimidation, or resort to any other method designed to coerce the debtor at the time the secured party takes possession.

III. When repossessing the collateral, no public official or police officer may be present at any time unless a judicial order authorizes his presence.

Sources:

Charter of the Agricultural Bank of Bolivia (agricultural pledge), Articles 57 & 58, Supreme Decree 16699 of July 15, 1979 and UCC § 9-507.

Commentary

For lenders to be willing to accept security interests in personal property the collateral should maintain its value during the life of the loan. Consequently, if it takes six months to repossess the collateral, lenders will not accept cattle, fruit or clothes as collateral. Typically, personal property, in comparison to real property, rapidly decreases in value with the passage of time. Consequently, a key element for the acceptability of personal property as collateral is the time it takes to recover the property. The people interviewed for the background study for this draft indicated that the procedure for repossession and sale of collateral takes a great deal of time and is burdensome. Such costs in time and money eliminate as collateral much of personal property whose economic value might be used to secure loans. To permit the secured party to take possession and sell the collateral is a key element in the reduction of the time needed to repossess. This has been the experience in

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

countries with ample credit based on movable property such as the United States and Canada.

ARTICLE 43 (Duty to turn over collateral)

I. Any secured party who has possession of collateral shall turn over the collateral to a secured party whose secured obligation is due and whose security interest has priority so that the security interest can be enforced in the manner regulated in this law.

ARTICLE 44 (Sale without possession)

I. Any collateral may be sold even if the debtor or the owner has possession of the collateral. In this situation, the buyer of the property has the same right to take possession as the secured party had.

ARTICLE 45 (Rights of the debtor)

I. Even when a security interest is being enforced in accordance with the provisions of this chapter and no matter how much is owed to the secured party, the debtor has the right as against the secured party to the restitution of any money or repossession of the collateral in accordance with the rules of the Code of Civil Procedure.

II. At any time before the sale of the collateral or before the conclusion of a private sale contract, the debtor may pay the secured party the full amount owed, together with the expenses and accrued interest, and thereby recover ownership and the right to possession of the collateral. In this case, the secured party shall accept the payment and immediately stop any enforcement procedure.

Commentary

The secured party will be able to choose to act under the procedural rules for enforcement found in the Code of Civil Procedure or under the rules of this chapter. The provisions of this chapter set out a flexible and speedy procedure permitting secured parties to control the repossession and sale of the collateral. The permission granted the secured party to repossess the collateral in case of default is not the equivalent of allowing the secured party "to take justice into his own hands." It is clear that the secured party must have recourse to the judicial system if the debtor opposes, whether or not justifiably, repossession and sale of the collateral by the secured party. In this way the draft law balances the need to protect the interest of the secured party in the prompt collection of the debt with the protection of public order and social peace, as well as the protection of the debtor from abusive conduct by the secured party. The secured party, as well as the debtor or interested third parties, can exercise their rights by common actions provided in procedural laws.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

ARTICLE 46 (Sequestration)

I. If it is not possible to repossess the property by peaceful means, the secured party may request the competent judicial authority to issue a judicial order to sequester the property, enclosing with the order a copy of the security agreement and a description of the property to be sequestered.

II. Without the need for prior drawing of lots or any prior formality, and on the same day that the request is received, the judge shall issue the relevant judicial order to the responsible police authority.

III. The property sequestered under the procedure set out above shall be turned over to the secured party, who shall be liable for the charges and risks arising from the transportation and storage of the property.

ARTICLE 47 (Duties of the secured party when selling the collateral)

I. The parties to the security agreement may agree on how the collateral will be sold following default.

II. In the absence of an agreement, the secured party shall sell the collateral in accordance with the trade usages for such property and in a suitable market. The method, manner, place and time of the sale shall follow the commercial customs of sales of persons who deal in similar types of property on a regular basis. The sale may be by private contract, an auction announced in a newspaper with a national circulation, or some other manner which is commercially reasonable for the type of property and the market for them in that location. Similarly, the secured party shall incur those expenses necessary to improve or preserve the property and which are commonly incurred for property of that kind.

III. Before the sale, and subject to liability for damages, the secured party shall give written notice of the sale to the debtor, to all secured parties who have filed a financing statement against the same debtor with respect to the property being sold, and to the owner of the collateral if the debtor is not the owner. This notice shall be sent to the secured parties and debtors at their special addresses and to the owner of the property at the owner's legal address. The notice shall be received not less than one day before the date of the sale. The notice shall mention the place, day and time of the auction or the conclusion of the private contract of sale.

IV. The secured party, after taking possession and giving notice in accordance with paragraph III, shall initiate and conclude the process of enforcement within a period of time reasonable for the type of property, but in no case shall this period exceed 40 days from the time that the secured party takes possession of the property.

ARTICLE 48 (Rights of the owner of the collateral)

I. When the secured party knows that the debtor is not the owner of the collateral, the owner of the collateral has the right to:

(a) collect the surplus of the proceeds of the sale of the collateral in accordance with the provisions of Article 50;

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

(b) receive a statement of account in accordance with the provisions of Article 21;
(c) be notified of the sale of collateral in accordance with the provisions of Article 47; and
(d) redeem the collateral in accordance with the provisions of Article 45.

ARTICLE 49 (Sale of property in possession of the debtor)

I. The parties may agree that the sale of the collateral shall take place without the need for the secured party to take possession of the property. In this case, the parties may agree on the rules under which the debtor may retain possession of the property in the capacity of a lessee as against any person who acquires rights in the property.

Source:

John Spanogle, *Proposed Polish Charges Act* (1991), Art. 10(5).

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

ARTICLE 50 (Distribution of the proceeds of the sale)

I. If the collateral is sold, the proceeds received from the sale shall be liquidated and applied in the following order:
   (a) payment of the expenses which result from maintenance, preservation, repossession and sale of the collateral;
   (b) payment of the capital and interest on the obligation secured by the senior security interest;
   (c) any surplus shall be distributed to junior secured parties in the order in which these interests were perfected. Only if a secured party entitled to priority has been paid in full may a subordinate secured party receive payment.

II. Within three days after the receipt of the proceeds of the sale of the collateral, the surplus, if any, shall be turned over to the debtor or his representative, or to the owner of the collateral if the debtor is not the owner.

III. Any agreement between the secured party and the debtor which derogates from this Article shall be of no effect.

ARTICLE 51 (Credit balance in checking account)

I. If the security interest covers the credit balance in checking accounts, savings accounts or time deposits, the bank or financial institution shall, on receiving a notice from the secured party that the secured obligation has not been paid accompanied with a copy of the relevant financing statement, continue to accept deposit orders but shall not honor payment orders received after the notice. The bank or financial institution shall retain the debtor's funds until the full amount of the secured obligation is satisfied.

II. After it freezes an account, the bank or financial institution shall, on the request of the secured party, pay the secured obligation. The bank or financial institution shall not be liable for this payment as long as the bank or institution strictly complies with the instructions received.

III. The bank shall notify the debtor of each proceeding against the debtor's account within 24 hours of the proceeding.

IV. These provisions also apply when the security interest covers proceeds from the original collateral.

Commentary

This is included to preserve the responsibility of banks and financial institutions to the debtor when a security interest covers the credit balance in checking accounts, savings accounts or time deposits.

It is the responsibility of the banking entity to verify that the name and the signature of the debtor on the copy of the financing statement presented by the secured party are the same as the name and the signature of the owner of the account, in the same way that a bank should verify the signature on checks that it pays.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

ARTICLE 52 (Property represented by warehouse receipts)

I. When the security interest covers a warehouse receipt, the secured party may sell the goods represented by the receipt and distribute the proceeds in accordance with the provisions of this chapter. The proceeds received from the sale shall be also be distributed in accordance with the provisions of this chapter.

II. If unpaid, the secured party with a security interest in a warehouse receipts may bring an enforcement action against the endorsers and guarantors.

ARTICLE 53 (Property represented by instruments)

I. A secured party who has received instruments as collateral is subrogated to the rights of the debtor in order to preserve the effectiveness of the account represented by the instrument and the rights of the debtor. The secured party shall be liable for any failure to preserve the effectiveness or the rights of the debtor.

ARTICLE 54 (Collection of accounts receivable)

I. Upon default by the debtor, the secured party who has a security interest in accounts receivable, may take one or more of the following steps:
   (a) take possession by peaceful means of the documentation for the accounts receivable or of the place of payment in accordance with the provisions of this chapter;
   (b) notify the account debtors by certified notice that payments are to be made to the secured party;
   (c) sell or assign the accounts receivable to another person for a price in accordance with the requirements prescribed in Article 47 for the sale of property. The assignee may take the same steps as the secured party may.

II. Every account debtor who receives a notice in accordance with this law shall make subsequent payments in accordance with the instructions that he has received.

III. The secured party shall notify each of the other secured parties in accordance with Article 47.

IV. The secured party shall apply the payments made in accordance with Article 50.

V. The notification to account debtors shall be accompanied by a copy of the financing statement.

ARTICLE 55 (Bankruptcy of the debtor)

I. When an insolvency administrator is appointed in the insolvency or bankruptcy proceedings of the debtor before a secured party with a perfected security interest has repossessed the collateral, the administrator shall turn over the collateral to the secured party upon the request of that party.

II. The secured party may enforce his right to satisfy the debt from the collateral without the intervention of the administrator in debtor's bankruptcy proceedings,

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

except when the security interest was created under any of the following circumstances:

(a) The security interest was created during the year immediately preceding the commencement of the insolvency proceedings or the declaration of the debtor's bankruptcy.

(b) When the security interest was created or later, the debtor has not received any consideration or the consideration received is significantly less than the market value of the collateral.

(c) In these circumstances, the judge in the insolvency or bankruptcy case may modify or adjust the contract if to do so benefits the secured party.

III. A security interest created after the commencement of insolvency proceedings or the declaration of the debtor's bankruptcy shall have no effect unless authorized by the judge in the insolvency or bankruptcy case.

ARTICLE 56 (Liability)

I. If a secured party repossesses the collateral in contravention of the provisions in Article 42 (Repossession upon default) of this law, the secured party shall pay to the debtor a sum equivalent to 30 per cent of the amount of the debt, return the repossessed property or right, and indemnify the debtor for any damages resulting from the wrongful repossession.

II. If a secured party sells the collateral in contravention of the provisions of Article 47 (Duties of the secured party when selling the collateral) of this law, the secured party shall pay the debtor a sum equivalent to the amount of the unpaid debt, or the unpaid balance of all the obligations secured by the same collateral, or the difference between the market value of the property and the amount received from its sale, whichever is highest. In addition, the debtor may recover from the secured party appropriate compensation for any damages.

III. To determine the market value of property, the secured party and the debtor shall each appoint a private appraiser. If the difference in the appraised values is less than 20 per cent, the difference shall be divided in half; if the difference is greater than 20 per cent, the appraisers shall appoint a third appraiser to appraise the property. The market value shall be the average between the value given by the third appraiser and the appraised value closest to this third value.

Commentary

Many people state their concern about the time, cost and lack of certainty in the courts and the attendant abuses by secured parties. As a consequence, the draft law includes penalties for secured parties who commit certain specific violations. These penalties provide an incentive for secured parties to act properly, given that the minimum penalty is clearly established in case of abuse. The secured party is entitled to repossess and sell the collateral. Consequently, the penalties escalate in the following manner: if there is a violation of public order, use of force or intimidation and the police or other public authorities are present or

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

assist, the secured party loses thirty percent of his claim and has to return the collateral to the debtor. If the secured party has not complied with the requirements for the sale of the collateral in a commercially reasonable manner resulting in a loss for the debtor and other secured parties with an interest in the same collateral, the draft establishes a private procedure for resolving the debtor's protest and for determining the market price.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

CHAPTER SIX: FINAL PROVISIONS

ARTICLE 57 (Real property by destination)

Real property by destination may be subject to a mortgage when the principal property to which the real property by destination adheres is subject to a mortgage of real property in accordance with the provisions of the Civil Code. In this case, the relative priority of the security interest in real property by destination is determined by the provisions of Chapter Three and specifically by Chapter Three: Article 26 (Priority between a security interest in fixtures or accessions and a mortgage) of this law.

ARTICLE 58 (Repeals)

I. The following legal provisions are repealed:
   (a) Civil Code, Title XXII: Of pledge, articles 3728-3770; Title VII, Chapter III: Of the effect of contracts, article 2483(7).
   (b) Commercial Code, Title IX: Of commercial pledge, articles 506-518; Title VII, Chapter II: Warehouses, articles 474, 476, 478, 479 and 483.
   (c) Law of Agricultural or Industrial Pledge (La Gaceta, Diario Oficial No. 174 of August 14, 1937).
   (d) Law of Commercial Pledge (La Gaceta, Diario Oficial No. 60 of March 17, 1992).
   (e) Law on Qualifications (La Gaceta, Diario Oficial No. 226 of October 9, 1934).
   (f) Any other provision contrary to this law.

II. The following legal provisions are modified:
   (a) Civil Code, Title XI: Of the transfer of rights, Chapter 1, articles 2720, 2721, 2735 [?] and 2743, which, as modified, read:

   "Article 2720: The assignment is not effective as against the debtor unless the assignee has notified the debtor or the debtor has accepted the assignment, and is not effective against third parties unless a notice has been filed in the Archive of Security Interests."

   "Article 2721: The notification may be made by any means and may be verified by any person who has reached the age of majority."

   "Article 2743: Rights in litigation may be assigned by a non-notarized instrument without the need to draw up a judicial act in the proceeding."

   (b) Civil Code, Title VII, Chapter III: Of the effect of contracts, article 2483(1), which, as modified, reads:

   "Article 2483 Contents of public instrument]

III. Acts and contracts which have as their object the creation, transfer, modification or extinction of rights in real property, except real property within the sphere of

application of the Law on Security Interests in Personal Property, may be created by a non-notarized instrument."

(a) Articles 468-473, 475, and 480-485 of the Commercial Code are modified by repealing the provisions on notes issued against warehoused property but continuing the provisions on warehouse receipts. The new text reads:

Art. 468: "Warehouses are establishments to which commodities are entrusted for deposit, conservation, custody, and occasional sale, and which issue documents called a 'warehouse receipt'.

Art. 469: "A warehouse receipt which represents the commodities is an instrument used for the sale of the commodities, transferring title to the person acquiring the receipt.

"To have legal effect, the receipt must include indications needed to identify the name, profession and address of the depositor and the nature, quantity, quality, condition and value of the commodities."

Art. 470: "A warehouse receipt shall be kept in a stub book and shall be issued in a single form."

Art. 471: "Warehouse receipts shall state expressly whether the commodities are insured and how much is owed for rights and taxes."

Art. 472: "Warehouse receipts may be assigned by endorsement. The endorsement of the receipt assigns the right to dispose of the commodities upon condition of paying the interest secured by the receipt."

Art. 473: "The warehouse receipt may be endorsed in blank. The endorsement in blank transfers to the holder the rights of an endorsee."

Art. 474: Repealed.

Art. 475: "The sole holder of a warehouse receipt may pay the debt secured by the receipt, even before the due date of the debt. If unable to reach agreement with the secured party, the holder can deposit with the warehouseman the capital and the interest secured by the warehouse receipt and then freely dispose of the commodities withdrawn from the warehouse."

Art. 476: Repealed.

Art. 477: Repealed.

Art. 478: Repealed.

Art. 479: Repealed.

Art. 480: "If the deposited commodities are insured against fire, the holder of the receipt has the same rights in insurance proceeds payable in the case of a fire as the holder has in the insured commodities."

Art. 481: "If the warehouse receipt is lost, on the request of the owner of the receipt, the judicial authority, having determined that the information about the loss is true and that the petitioner is the owner of the receipt, shall require an appropriate bond and order the warehouseman to issue a duplicate receipt."

Art. 482: "The warehouseman may, in conformity with its articles of association, acquire negotiable instruments secured by a security interest in warehouse receipts, and exercise the rights attributed to this class of instruments."

Art. 483: Repealed.

Art. 484: "The holder of the receipt has the right to ask that the deposited goods be divided, at his expense, into separate parts or lots, and that the warehouseman deliver a distinct receipt for each part or lot in exchange for the single receipt for the undivided goods."

Art. 485: "The provisions of the Law on Security Interests in Personal Property is applicable to this Chapter."

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789

IV. Articles 3808-3883 and 3937 of the Civil Code are not applicable to security interests over property or rights governed by this law.

V. The following are not applicable to security interests in property or rights governed by this law:

(a) Law on Fees for the Public Register, Decree No. 40-91 (La Gaceta No. 182 of September 31, 1991), and

(b) Any other legal provisions or regulations with respect to public registers.

VI. The rules on the admissibility of public and private documents are not applicable to security interests in property covered by this law with respect to the formality required of the security agreement and related documents. The following rules in particular do not apply: Civil Code, Title VI, Chapter III (Of public documents), articles 2364-2384, and Chapter IV (Of private documents), articles 2385-2398; Code of Civil Procedure, articles 1151-1195.

ARTICLE 59 (Regulations)

I. The Executive shall make the necessary regulations for the organization and operation of the Archives of Security Interests not later than sixty days after the publication of the present law.

ARTICLE 60 (Transitional provisions)

I. Secured transactions, such as pledge and mortgage, which have been created and registered before the effective date of this law are governed by the corresponding regulations of the repealed legal instruments.

II. The registers for the legal instruments referred to in the preceding paragraph shall transfer their books, archives and databases to the Archives not later than sixty (60) days after the Archives begins to function.

III. Encumbrances created and perfected in accordance with repealed regulations shall remain effective with respect to preferences, the right to trace the collateral into the hands of third parties, its effect as to third persons, judicial collection and the exercise of other rights.

1201 PENNSYLVANIA AVENUE NW, SUITE 300
WASHINGTON, DC 20004
TEL (202) 646-1787
FAX (202) 966-1789