Foreword by Boris Kozolchyk

I. Commercial Law as a Quiet Agent of Social and Economic Change

As an agent of social and economic change, commercial law has traditionally done its work quietly, if not imperceptibly. It took centuries for the medieval world to realize that the various forms of entrustment of goods and money by Mediterranean Arab and Jewish merchants to their travelling agents and foreign correspondents (who were mostly "formal" or religious brethren or friends) replaced caravans as the main method of international trade. It also took a long time for the Christian medieval world to realize that the bill of exchange it was using to transfer funds and, at the same time, evade the prohibition of usury, was the same used by Arabs and Jewish merchants to pay or extend credit. Similarly, Renaissance Europe failed to appreciate the significance of the double entry bookkeeping practiced by merchants in Florence, Genoa, Siena and Venice until an increasing number of Europeans needed a more objective verification of profits and losses to satisfy investors in, or lenders to, maritime and overseas ventures.

A Nobel Prize committee attempting to reward the inventor of fiduciary agency, bills of exchange, double entry bookkeeping, publicly held corporations or documentary letters of credit, to mention just a few institutions that come to mind, would not be able to identify a responsible merchant, banker, lawyer, judge or legislator. Why? Because viable commercial legal institutions usually result from the cooperative efforts of many merchants, lawyers, judges, legislators and even law professors interacting in similar or different localities.

II. Influential Prototypes of Secured Commercial Lending and the Cycle of Development of Commercial Legal Institutions

The first stage of the creative cycle of a commercial legal institution starts with a practice or usage of trade limited to a group of skilled and respected practitioners. The second stage comes about when the practice is adopted by most of the practitioners of the trade in a given region or profession. The third stage takes place when the professional or regional custom is approved by legislators, judges, lawyers and legal scholars.

A. The English Eighteenth and Nineteenth Century Commercial Loan as a Prototype of the Self-Liquidating Loan

Secured commercial lending was an eighteenth century English invention. Its real estate counterpart, the real estate mortgage loan or loan secured by a mortgage, was of a much longer duration. At a minimum, it lasted five years. In

the event of the debtor's default, the source of repayment was the land or building, a non-moveable asset whose value was assumed to remain steady or to increase over time. In contrast, the commercial loan was given for a period of time measured in days and months and only occasionally in years. In the event of default, the source of its repayment was moveable goods that were saleable, albeit often perishable or quickly depreciable.

Reliance on saleable goods was consistent with the self-liquidating nature of the commercial loan. Self-liquidation, as envisaged in the English commercial loan, meant that the loan was to be repaid from the proceeds of the resale of the business assets. Significantly, the business assets that made repayment possible were the same ones whose acquisition was made possible by the commercial loan.

The groups of merchants who participated in shaping the eighteenth and nineteenth century English practices on commercial loans included the following: goldsmiths, who lent on the collateral of jewelry which most often remained in their possession until they were repaid; general or unspecialized bankers, who lent to merchants and often took as security a non-possessory pledge of their borrowers' inventory known as the "floating charge"; "merchant bankers," who lent on the security of documents of title such as bills of lading and warehouse receipts and on the security of the goods and proceeds that resulted from selling the documents or the goods; and the "factors," who lent on the strength of commercial and consumer accounts receivable either in the form of invoices or bills of exchange and promissory notes. The credit given by these bankers and factors stood in sharp contrast with that of "moneylenders." Moneylenders lent mostly to consumers; their loans were often unsecured, and they charged higher rates of interest than that charged by bankers and factors.

Nineteenth century English practices evinced a secured lending pyramid. Retailers and moneylenders were at the base; wholesalers, bankers and factors were at the next level. At the top of the pyramid was the Bank of England as lender or discounter of paper produced at the lower levels of the pyramid. These practices, however, were not fully recognized by statutory or decisional law. Some of the most important practices, like the lender's "floating charge" over a merchant's inventory, remained uncodified and provided insufficient notice to secured creditors and bona fide purchasers. Even during Charles Dickens' time, the debtor's prison was still a means for enforcing the collection of commercial loans.

B. The Twentieth Century United States Commercial Loan as a Prototype of Contemporary Secured Lending

Twentieth century United States commercial lending added more levels and intermediaries to the English pyramid of credit practices. To begin with, United States banks were much more numerous and unspecialized than the English banks. Instead of the "city," "merchants," "clearing" and other types of banks

whose total number did not exceed one hundred, the number of banks engaged in commercial lending during its twentieth century apogee in the United States exceeded 15,000. In addition, through the use of credit cards and "personal lines of credit," United States banks extended much more credit to consumers at reasonable rates of interest than was ever extended by the English banks or moneylenders.

Widespread consumer credit at reasonable (or near to the commercial) rates of interest made it possible to finance not only consumer purchases from retailers, but also retailers' purchases from wholesalers, wholesalers' purchases from manufacturers and, finally, manufacturers' production. The supply and demand of commercial and consumer credit in the United States are such that any goods or services with ascertainable and obtainable value in the market place are acceptable collateral, including future inventory, accounts receivable, proceeds, intangible objects such as rights to the performance of contracts, dematerialized investment securities, intellectual property of all types and good will.

C. The Peculiar Features of the Secured United States Commercial Loan

The speed with which the United States commercial and consumer credit market operates demands that the granting of a security interest in collateral not be predicated upon proof of title to the collateral. "Historical" ownership of collateral is irrelevant; a mere right to the possession of the collateral suffices. The United States commercial credit market also demands a unitary security interest to make the adjudication of priorities certain. It also demands a reliable and accessible form of notice to other creditors and bona fide purchasers. Most of this notice is given by filing in public registries, whether in paper-based or in electronic form. Nevertheless, the creditor's possession, as in the traditional pledge, is still regarded as a form of notice.

Another important feature of the United States secured loan is that in the event of debtor default, the creditor can pursue his own recovery of the collateral or its market value without having to go to court. He can engage in self-help as long as he does not violate constitutional due process or does not "breach the peace." Neither the prohibition of the *pactum commisorium* (about which more in the Day 1 and 2 discussions hereafter) nor the debtor's prison belong in this system of lending.

D. The Modernization and Unification of United States Secured Lending Law

During the first half of the twentieth century, the United States law of secured loans was a mosaic of different and often mutually exclusive transactions.

Among these were chattel mortgages, conditional sales mostly without registration, factoring supported by equipment trusts, trust receipts, secured loans disguised as leases, statutory liens and so on. Some of these devices were registered; others were not. Often what was a perfected security interest in one state was not in another, or what was recognized as a prior right in one state, was not so recognized in another.

Much of the credit for the modernization and unification of United States law, including the creation of a unitary security interest, goes to the National Conference of Commissioners on Uniform State Laws and to the American Law Institute. These entities drafted and helped enact the Uniform Commercial Code by a number of states in 1952 and throughout the nation in subsequent years. Article 9 of this code is devoted to secured transactions law.

The success of this code, and especially of Article 9, has been remarkable. Commercial law is uniform in most respects throughout the United States, and commercial and consumer credit at reasonable rates of interest is readily available (perhaps too readily available in the view of some economists and parents of children with access to credit cards).

III. Commercial Lending in Latin America and the Caribbean

In contrast with the United States prototype of commercial lending, commercial and related consumer credit is still largely unavailable in Latin America and the Caribbean; and when available it is extremely costly. The unavailability and high cost of credit reflect high credit risks or the inability to obtain payment in commercial and consumer loans quickly and inexpensively. As recently as eighteen months ago, the Central Bank of Brazil reported that roughly one third of the cost of commercial credit (with rates in excess of thirty percent) was attributable to the creditors' inability to collect on loans or to realize on loan collateral. The absence of secured lending in Latin America and the Caribbean is quite costly in macro as well as in microeconomic terms. World Bank economists have estimated the loss to a country's GDP to be in excess of ten percent.

Numerous statutes, court decisions and commercial practices have attempted to eliminate the high risks of commercial lending in Latin America. Unfortunately, none of these has succeeded, although in fairness it has not been for lack of trying. As early as 1914, Argentina enacted an agrarian pledge statute that attempted to achieve certainty of collection by recording the pledge and immobilizing the collateral. The debtor's failure to keep the collateral immobilized or under lock and key in the debtor's own or in a third party's warehouse could have landed him in jail as a thief or embezzler. Similarly restrictive statutes were enacted subsequently in Brazil, Chile, Colombia, Honduras, Mexico, El Salvador, Panama, Peru, to mention only a few.

Costa Rica experimented for a while with a less violent and physically coercive enforcement practice. Debt collectors, who were dubbed *"pericos"* (parakeets), dressed in vivid green silently followed the delinquent debtors in public. The silent pursuit continued until the shamed debtors repaid their loans. This practice was discontinued, however, after some of the parakeets mysteriously disappeared never to be seen again. Nevertheless, Costa Rica persisted on relying on the personal element of enforcing security interests in moveables. This most democratic of countries had a civil code provision, which was nothing but a variant of debtor's prison. Its remedy was known as *"apremio corporal"* and it was in force until rather recently when it was declared unconstitutional. The *apremio* resulted from a court order directing the debtor to return the collateral, pay the debt or face imprisonment from two months to two years because of contempt of court.

Since the late 1920's, Latin American countries have been enacting secured transactions laws involving other (non-agricultural) collateral whose possession could remain with the debtor. With the exception of Mexico's Law of May 23 of 2000 on secured transactions (hereafter referred to as Mexico's STL), these laws assume that the debtor has title to the collateral, thereby impeding loans that rely on future acquired collateral such as is common with inventory, accounts and proceeds collateral. Some require registration or other forms of public notice while others do not. A major element of the uncertainty of Latin American and Caribbean secured transactions laws is the inadequacy of local registries. An inscription on the wall of a Salvadoran registry aptly summarizes the feeling of those attempting to obtain timely and accurate information about the encumbrance of a debtor's business assets: *"Aquí lloran los valientes"* (Here, even the brave cry). Real estate and real estate mortgage law influences the organization of these registries. Consequently, they rely on detailed description of the collateral, including metes and bounds. Clearly, such a description is inappropriate for each of the components of, say, a merchant's inventory or for each item in a retail store's or wholesaler's accounts receivable. The information in these registries, then, is not found by looking for the names of the debtors as is commonly the case with contemporary United States and Canadian registries.

Finally, with the exception of the Mexican STL, most of the Latin American secured transactions laws do not allow the secured creditor to repossess collateral or to sell it extra-judicially. Judicial approval in Latin America usually takes years to obtain and at a considerable cost. Debtor's prisons in various guises are still found in Latin America.

IV. The Highly Visible Law-Making Task of this Group of Experts

Unlike the traditionally quiet and imperceptible law-making of customary commercial law, the eyes of the commercial credit marketplace are upon this group of experts. In February 1998, the Mexican Notarial Association was the host to the

Congress of the Latin Notariat at which I was invited to describe the draft of a secured transactions law that the National Law Center for Inter-American Free Trade (NLCIFT) had been discussing with the Mexican government (hereafter referred to as the SECOFI Draft). This SECOFI Draft evolved into a Model Inter-American Law on Secured Transactions, presently considered by the OAS and this drafting group. A group of Hungarian notaries informed me that the volume of secured lending in Hungary had nearly doubled after the Hungarian enactment of a secured transactions law that was not as comprehensive and certain as the SECOFI Draft. They expressed a strong interest in amending their law to make it consistent with Mexico, the rest of Latin America and the Caribbean. This Notarial Congress took place on the heels of a summit of Western Hemisphere banking associations hosted by the NLCIFT, the Mexican Bankers' Association, the then United States Council for International Banking (USCIB), (presently the International Financial Services Association - IFSA) and the Federation of Latin American Banks (FELABAN). This summit meeting approved the principal features of the SECOFI Model Law.

Following this meeting, the NLCIFT received requests for the SECOFI Model Law and clarification thereto from staff members of the United Nations Commission on International Trade Law and from African, Asian, European and Latin American scholars and graduate students. In response to the worldwide interest, the Mexican Ministry of Foreign Relations, the Institute of Legal Research at the National Autonomous University of Mexico (UNAM) and the Institute for the Unification of Private Law (UNIDROIT) sponsored an international meeting in November 2000 in Mexico City during which the SECOFI Model Law was discussed and compared with other national statutes and international drafts. The UNIDROIT officials present expressed an interest in considering the Model Law as a possible model for nations outside of the Western Hemisphere.

Why is there so much interest by so many nations and organizations in this Model Law? The answer is twofold. From an economic standpoint, it would be foolhardy, if not grossly negligent, for any nation intent on competing globally to ignore the benefits of a good secured transactions law. Unless the productive sectors of that nation have access to commercial and consumer credit at reasonable rates of interest, they will not be able to compete with other nations and producers who do. Access to such credit in the age of artificial satellites and the Internet could be literally only a few seconds away.

Furthermore, if we do our job well during this meeting, we will create a regional credit market for the Western Hemisphere based upon uniform secured lending and registry rules. The size, purchasing and selling power of such a market is quite evident to traders, investors, lenders and borrowers around the world.

From a legal standpoint, civil law nations will find it highly beneficial to rely on a law such as the SECOFI Draft or the NLCIFT-OAS Model Law that are

compatible with basic concepts and principles of the civil, as well as the common, law. The prototype transactions that underlie these drafts were quietly worked out over three centuries of commercial lending, first in England and then in the United States. It is time now, in the presence of a watchful global financial marketplace, for this group of experts to ensure the drafting of a cost effective and fair law. If we succeed, commercial credit should flow abundantly to and within Latin America and the Caribbean. Our failure would be so costly that it should not even be contemplated.

V. The Reference to the Following Proceedings as Preliminary Work

The expression "Preliminary Work" is an English version of the French *Travaux Preparatoires* as usually found preceding the text of important legislation or treaties. The function of Preliminary Work proceedings is to record the discussions that explain how and why a statute or treaty was drafted, or how it should be redrafted if redrafting is required. Originally, the NLCIFT was going to publish a literal transcript of the proceedings. This became impossible because of difficulties with the taping and translation of the sessions. Hard as the translators and the recording equipment tried to faithfully reflect what was said, it was simply too much for both systems. Consequently, the transcripts had to be reconstructed and edited, although the editorial work was undertaken with the greatest of rigor and respect to the spoken word in order to render the intent of the speakers as close as possible to what was recorded and translated.

The editing was undertaken by the NLCIFT and the Editorial Staff of the *Arizona Journal of International and Comparative Law* (AJICL). This writer edited day one of the proceedings, and co-edited days two-four with John Wilson and Mariana Silveira.

VI. An Expression of Appreciation

This Group of Experts meeting has been more than eight years in the making, including numerous preparatory meetings. The first meeting leading to a study of commercial credit and secured transactions law in the NAFTA countries took place in Tucson on May 16-18, 1993 under the sponsorship of the NLCIFT. Present at this meeting were the following: Professor William Boyd of the James E. Rogers College of Law at the University of Arizona and Professor Ronald C. C. Cuming of the University of Saskatchewan and first coordinator of the NLCIFT secured transactions law project; Dale B. Furnish of the Arizona State University College of Law; Ingeniero Guillermo Jiménez, Director of International Operations of Banamex, Mexico's largest bank; Lynn Lopucki (at that time a Professor of Law at the University of Wisconsin School of Law); Dr. Juan José Ríos, Professor of Law at the National University of Mexico and a researcher at the Mexican Instituto

de Investigaciones; Lic. Octavio Rivera Farber, representative of the Mexican Notarial Bar Association; Dr. José Roldán Xopa (at that time an advisor to the Mexican Public Registry); Dr. Oscar Salas, then president of Latin Title (an international title insurance company) and one of the world's experts on the land registry law of civil law countries; Professor Alejandro Garro of Columbia University and one of the hemisphere's experts on secured transactions law; and Harry Sigman, Esq., one of the United States' experts on secured transactions law and at that time a member of the drafting committee of the National Conference of Commissioners of Uniform Laws for the revision of Article 9 of the UCC .

Many of these scholars and banking and government officials continued to be involved during the next stages of the NLCIFT secured transactions law project. The NLCIFT owes a special debt of gratitude to Dr. José Roldán Xopa who arranged for initial contacts with the administrations of Presidents Carlos Salinas de Gortari and Ernesto Zedillo and with the Mexican Notarial Bar Association. Much gratitude is also owed to Ingeniero Guillermo Jimenez who, as a high Banamex official, obtained the support not only of Banamex, but also of the Mexican Bankers Association. Ing. Jimenez's leadership also made it possible to hold the summit meeting of Western Hemisphere banking associations referred to earlier. The Mexican Notarial Bar Association continued to be involved with NLCIFT's efforts almost until the end of the drafting process. It produced a very valuable draft of a Mexican Secured Transactions law. This draft was the first to successfully bridge the gap between civil and common law institutions. Leading this notarial effort were three distinguished and highly insightful jurists: Licenciados Adrian Iturbide, Miguel Alessio Robles and Javier Arce Gorgollo. These notaries were also responsible for the discussion of the SECOFI Draft in the Veracruz Congress of the Latin Notariat. In the process of drafting the OAS Model Law, the NLCIFT owes special gratitude to José Astigarraga of the Law Office of Astigarraga Davis Mullins & Grossman, a member of the Group of Experts, a co-United States Delegate to CIDIP-VI, and a member of the board of directors of NLCIFT. Not only did José co-host the meeting of drafters of the SECOFI Model Law in Miami, Florida but he also contributed valuable suggestions for the drafting of this Model Law and helped organize and fund the summit of Latin American banking associations in Mexico City, as well as the present meeting.

Following the Tucson 1993 meeting, a working group was put together under the direction of Professor Ronald C. C. Cuming. Professor Cuming spent a sabbatical semester at NLCIFT designing eight financial scenarios of commercial loans, contrasting law and practice in Canada, Mexico and the United States. He was aided in this effort by Todd Nelson, Esq., who upon Professor Cuming's return to Canada became the second coordinator of the project. Professor Cuming and Todd Nelson were supported by the research of Licenciados Juan Manuel Trujillo, Juan Enrique García, Luis Felipe García, Alberto Fuentes, Andrés Félix, Jesús

Madrazo and John Wilson Molina, Esq. The preliminary thinking on the planning of registry law reform came from Arquitecta Angelina Muñoz, Harry Sigman, Esq. and Dr. Oscar Salas. Angelina Muñoz has been one of the most successful innovators of Mexico's Public Registry system. Everett Wohlers, Vice President of NIC-Conquest, has also been very generous with his time and expertise on registry related matters.

Following Todd Nelson's departure to Mexico, where he is presently teaching at the Technological Institute of Monterrey, John Wilson Molina became the present project coordinator. It was John Wilson who, together with Lic. Francisco Ciscomani (SECOFI's head of de-regulation legislation) and this writer, drafted the SECOFI Draft. In modified fashion, the SECOFI Draft became the Mexican STL and the NLCIFT-OAS Draft Model Law.

The STL was adopted by Mexico's Congress on May 23, 2000. Unfortunately, this statute has some serious flaws that must be corrected for it to be effective. Nevertheless, the STL represents a significant positive step in the history of legal reform in the Americas. The STL would not have been enacted without the support of President Ernesto Zedillo. This support was obtained with the help of Lic. Bulmaro Pacheco, an advisor to President Zedillo, and of United States officials and private sector representatives. Among these are United States Representative Jim Kolbe, former Arizona Governor Fife Symington, Carol Colombo Esq., then president of the Arizona Mexico-Commission, and Donald Diamond, an Arizona businessman, all of whom followed up this writer's visit with President Zedillo and persuasively advocated Mexico's adoption of the SECOFI Model Law. Similar essential support from Minister Herminio Blanco was obtained by a group of prominent United States business leaders associated with the NLCIFT. Among them were: Paul Karon, President of Offshore International; Mike Tarasoff, then manager for Mexican Operations for Weyerhaeuser; Luis Fernandez, counsel for General Motors, Latin America; Gil Jimenez of Bank One; and José Palli, President of World-Wide Title, Inc. We are also very appreciative of the intellectual contributions of Edwin Smith, Partner at the firm of Bingham, Dana and Gould, LLP, Barkley Clark, Partner at the firm of Shook, Hardy and Bacon, LLP and Ulrich Drobnig, Director of the prestigious Max Planck Institute in Germany, who have provided valuable commentaries and drafting suggestions throughout the Model Law process. It gives me particular pleasure to express my gratitude to Professor Alejandro Garro for his continuous support to the NLCIFT secured transactions and it is a source of pride to this writer. As Professor Garro's former teacher, I encouraged him to undertake comparative legal research in this field after having done brilliant work in comparative land registry law.

The NLCIFT Model Law contains an e-commerce appendix or attachment referred to as the Uniform Inter-American Rules for Electronic Documents and Signatures (IAREDS). IAREDS's history started with a meeting sponsored by the

NLCIFT and the Business Software Alliance at the OAS. A summary of what transpired in this meeting can be found in the *Arizona Journal of International and Comparative Law*, Volume 17, Number 1, 2000. The NLCIFT's e-commerce law project has been under the direction of Dr. Mariana Silveira, NLCIFT's Research Director, since its inception. Spiritual and financial support for IAREDS came from Dr. Horacio Gutiérrez, Senior Attorney, Microsoft Corporation, a remarkable lawyer and scholar. Coincidentally, Dr. Gutiérrez had contacted this writer for an "outside opinion" on a comparative (United States-Venezuela) secured transactions law study. The respect in which Dr. Gutiérrez is held by his colleagues at Oracle Corporation, Federal Express Corporation, Mastercard International Incorporated, Lucent Technologies and 3Com Corporation is responsible for the corporate support received by IAREDS and the OAS Group of Experts meeting in Miami. In addition to these companies and their counsels, special thanks must go to Mr. Jason Albert, Esq., of Covington & Burling, without whom IAREDS would not be a reality. Additionally, we would like to express our appreciation to Richard Smith Esq. of Davis Polk & Wardwell; to Jack Wiener of the Depository Trust Company, N.Y.; to Joseph Sommer of the Federal Reserve Bank, N.Y.; and to Richard Potok of Potok & Co. for their multi-faceted support of the project to draft rules on the acquisition and transfer of security interests in investments securities. We would also like to thank each and every one of our experts, advisors and correspondents throughout the Americas, who have contributed their time and expertise to the NLCIFT's secured transactions and e-commerce projects. This meeting could not have been a success without their feedback, enthusiasm and encouragement.

A special expression of gratitude is owed to our sponsors: Astigarraga Davis Mullins & Grossman, Federal Express Corporation, Ford Motor Credit Company, Greenberg Traurig, Hamilton Bank, Inter-American Development Bank, Lucent Technologies, MasterCard International Incorporated, Microsoft Corporation, NIC Conquest, Oracle Corporation, the Summit of the Americas Center at Florida International University-Miami, Florida, and 3Com Corporation.

I would also like to thank our board member, Phillip Robbins, Esq., for having attended this meeting in the midst of a very busy trial schedule. His devotion to the Center work has now taken a new dimension. Phil has become our Coordinator of Continuing Education Meetings. I must also thank the Center's Senior Consultant and Miami Representative, Jack Delaster. Jack is helping us with development efforts in the Miami area including the creation of a Miami office for the NLCIFT.

This meeting is the third that the NLCIFT has hosted in conjunction with OAS work. We are most grateful to Secretary General César Gaviria; Enrique Lagos, Assistant Secretary for Legal Affairs; Jean Michel Arrighi, Director - Department of International Law; and Kathleen Lannan, Legal Advisor - Department of International Law, for their support and guidance. Dr. Lagos, in particular, has been most helpful in facilitating the progress of the CIDIP process.

Since the 1994 Inter-American Convention on the Law Applicable to International Contracts, the CIDIP process has become an essential component of the economic development agenda for the Western Hemisphere

Last but not least, I would like to thank John Wilson Molina and Mariana Silveira for their excellent research, editing and coordination of their respective projects. And a special thanks to Stacy Patterson, my administrative assistant, for her skilled and devoted work in the organization of the meeting and in the preparation of a final text and to Lolita Grabb for her assistance in Center translations and reports. I would also like to express the NLCIFT's appreciation to the editorial board of the AJICL especially Tom Barnard, Justin Horwitz, Michael McCoy and the AJICL staff for their great care as editors and warm support of this most important project, and to Billie Kozolchyk for her customary care in editing this foreword.