

AMERICAN UNIVERSITY OF ARMENIA

A master essay:

Pledge/Lien on Movables: Creating Guarantees for Creditors.

The registration of the right of pledge.

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1. INTRODUCTION

The Transaction\Private Interests Involved\ Social Value

This paper is about the registration of the right of pledge (security interest)¹ over movable property. A person/legal entity needing financing to satisfy his consumer needs (for natural persons) or to enhance its working capital (for commercial organizations/manufacturing companies), in general, has two options. The first is to sell assets to obtain cash and the second option is to try to get financing secured by these assets. The difference is that in first case the person/entity requiring financing will lose the assets. In the second case the person/entity can get financing without losing the rights over the property, hence this very option becomes preferable. The same option may be convenient also for the potential financiers (creditors), as it allows them to have security interest in these assets, enabling to get satisfaction from the value of the assets when the debtor is in default.

From this perspective one of the most important issues for the creditors is to make known to other unsecured creditors of the debtor the fact that it has a security interest in a particular asset and also to subsequent creditors obtaining security interest in the same item of debtor's assets that it enjoys priority rights to get satisfaction from the value of the asset. Both these objectives can be attained by registration of the security interest (right of pledge) over the debtor's assets with a public registry.

Generally, all types of assets (movable and immovable) that can be legally owned can also be pledged. There are significant differences between the procedures of registration of security interests in movable and immovable properties, and legal effects of that registration. In this paper we will focus on the registration of security interests in movable assets which can be of significant interest both for the natural persons and/or entities entering in different transactions during their day-to-day activities which involve pledge of assets (e.g.

¹ The expressions "right of pledge" and "security interest" are used interchangeably throughout this paper to refer to a right in property which enables a creditor upon default by the debtor to recover his claim from the value of the pledged property.

individuals buying vehicles on hire-purchase basis, small businesses obtaining financing secured on their movable assets, etc), as well as for potential lenders. It should be noted, that the security interests in not all types of movable assets can be registered. The most common types of movable property the right of pledge over which can be registered are means of transportation, machinery, aircrafts, etc.

As stipulated by the law of the Republic of Armenia “On Maintenance of Movable Property Cadastre, on Registration of the Right of Pledge and Leasing over Movable Property”² the registration of the right of pledge over movable property is the recording by the respective authorized body of the facts of origination and termination of the right of pledge over movable property as well as any alteration/modification to such right.

The following parties are involved in the process of registration of security interests in movable assets:

a) Pledgor\Debtor

The pledgor is the owner of the property pledged. The pledgor in the majority of cases acts also as a debtor as the pledge of the property usually secures the debt. The Debtor is a person who owes payment or obligation secured .

b) Pledgee\Creditor

The Pledgee\Secured party is the Creditor of the Debtor enjoying first ranking priority rights to get satisfaction from the value of the pledged property. In the majority of cases the Creditor has lent a money to the Debtor or has obtained security interests in the Debtor’s assets based on the security (pledge) agreement or by virtue of law. Both natural persons and legal entities can act as Pledgees.

² The Law of the Republic of Armenia on Maintenance of Movable Property Cadastre, on Registration of Rights of Pledge and Leasing Over Movable Property (adopted on 11.05.2004, enacted on 17.06.2004, published on 16.06.2004, RA Official Bulletin No 31)

c)The authorized body conducting registration.

The registration is usually carried out by a body entitled to operate the public register of security interests. In the Republic of Armenia the mentioned function is carried out by the system of real estate property cadastre, which is entitled also to register the security interests over movable property.

The registration of the right of pledge over movable property involves two main groups of interests which determine its societal impact and underline the importance of registration in creation of a sound functioning market economy. The first is the interest of the Creditor to get first ranking priority rights to recover his claim from the value of the pledged property, i.e. to get priority over other creditors of the Debtor. The second group of interests are those of a state/society to create reliable database of registered secured interests. The database is deemed to enable the interested parties to obtain objective information on the existing rights of pledge over the property, the number of creditors enjoying priority rights to be repaid from the value of the pledged property, etc. The main objective of registration of security interests in movable property is the reduction of possible risks related to credit through publicizing the rights of creditors over pledged property. In general, the pledges are concluded to reduce the possible risk inherent in every case of credit. Without publicity creditors will not have sufficient certainty in their rights in the pledged property. Publicity enables the creditor to assess existing security interests which may affect the pledged assets as well as extends the possibility to third parties to reveal that the creditor has a priority right in the a particular item of assets.

Besides its advantages the registration of security interests may have also some disadvantages. For example, the registration can make the process of concluding a secured transaction and obtaining security interest in the pledged assets more complex, burdensome and costly.

2. ARMENIAN LEGAL FRAMEWORK

In the Republic of Armenia the legal framework for registration of the right of pledge is contained in the Civil Code of the Republic of Armenia³, the law of the Republic of Armenia “On Maintenance of Movable Property Cadastre, on Registration of the Right of Pledge and Leasing over Movable Property”, the Resolution of the Government of the Republic of Armenia No 1678-N dated 29 October 2004 “On Granting Authorities to Maintain the Cadastre of Movable Property, To Register the Right of Pledge, The Right of Lease Arising out from The Contract of Lease over Movable Property” and of the orders of the Chairman of the State Committee of Real Estate Cadastre under the Government of the Republic of Armenia.

Articles 226 and 234 of the RA Civil Code provide for the basic definition and content of the right of pledge, and how the contract of pledge is to be formed. In particular, article 226 headed “*Concept of the Right of Pledge*” stipulates that the right of pledge is the property right of the Creditor over the property of the Pledgor, which is also a measure to secure the implementation of monetary or other obligations of the Debtor towards the Creditor⁴. Section 3 of the same article sets that the Creditor of the obligation secured by pledge enjoys priority over other creditors of the Debtor to obtain satisfaction from the value of the pledged property. The same article also provides that the Creditors having earlier registered their rights of pledge in the register of pledge maintained by the authorized body earlier enjoy the preferential rights to obtain satisfaction from the value of the pledged property over the creditors who registered their rights later or those who have not registered their rights at all⁵. Article 234 sets the general requirements regarding the content and the

³ The Civil Code of the Republic of Armenia (adopted on 05 May 1998, published on 10 August 1998, RA Official Bulletin No 17)

⁴ **Հոդված 226. Գրավի իրավունքի հասկացությունը**

1. Գրավի իրավունքը (այսուհետ՝ գրավը) գրավատուի գույքի նկատմամբ գրավատուի գույքային իրավունքն է, որը միաժամանակ միջոց է գրավատուի հանդեպ պարտապանի ունեցած դրամական կամ այլ պարտավորության կատարման ապահովման:

⁵ **Հոդված 226. Գրավի իրավունքի հասկացությունը**

form of the contract of pledge. The general idea contained in the article is that the contract needs to be in written form and contain some basic information capable of identifying the parties to the contract, the pledged property and secured obligation (i.e. the names of the parties, places of their residence, the property pledged, the nature, size and maturity terms of the secured obligation)⁶.

The Law of the Republic of Armenia “On Maintenance of Movable Property Cadastre, on Registration of the Right of Pledge and Leasing over Movable Property” (hereinafter: the Law) regulates the whole procedure of the registration of the right of pledge over movable property. Article 6 of the Law entitled “*Object of Registration*” defines the list of movable assets the right of pledge over which can be registered. These are: means of transportation, self-moving mechanisms, machinery, flying and floating apparatuses⁷. Article 10 of the Law entitled as “*Legal Consequences of Registration of the Right of Pledge over Movable Property*” restates the idea contained in section 3 of the article 226 of the Civil Code and stipulates that the Creditors having registered their rights of pledge earlier enjoy priority

3. Գրավով ապահովված պարտավորության պարտատերը (գրավառուն) պարտապանի կողմից այդ պարտավորությունը չկատարելու դեպքում գույքի տիրոջ (գրավատուի) մյուս պարտատերերի հանդեպ գրավ դրված գույքի արժեքից բավարարում ստանալու նախապատվության իրավունք ունի: Գրավի պայմանագրից ծագող իրավունքը լիազորված մարմնի կողմից վարվող գրավի գրանցման մատչանում առավել վաղ գրանցած գրավառուն, մյուս՝ գրավի պայմանագրերից ծագող իրենց իրավունքներն առավել ուշ գրանցած կամ չգրանցած գրավառուների հանդեպ գրավ դրված գույքի արժեքից բավարարում ստանալու նախապատվության իրավունք ունի:

6 ՀՀ ԶՕՀոդված 234. Գրավի պայմանագիրը եւ դրա ձեւը

1. Գրավի պայմանագիրը պետք է կնքվի գրավոր:

2. Գրավի պայմանագրում պետք է նշվեն կողմերի անունները (անվանումները)

եւ բնակության վայրերը (գտնվելու վայրերը), գրավի առարկան, գրավով ապահովված պարտավորության էությունը, չափն ու կատարման ժամկետը:

7 «Շարժական գույքի կադաստրի վարման, շարժական գույքի գրավի իրավունքի, լիզինգի պայմանագրով վարձակալության իրավունքի գրանցման մասին» ՀՀ օրենք,

Հոդված 6. Գրանցման օբյեկտը

1. Սույն օրենքով գրանցման օբյեկտը շարժական գույքի եւ գույքային իրավունքների նկատմամբ գրավի եւ լիզինգի պայմանագրերից ծագող վարձակալության իրավունքներն են:

2. Գրանցման օբյեկտներն են՝

տրանսպորտային միջոցների, ինքնագնաց մեքենաների, հաստոցների, սարքավորումների, թռչող եւ լողացող ապարատների ու սարքավորումների եւ թվարկվածի բաղկացուցիչ մասերի, որոնք կարող են որակվել որպես անհատապես որոշվող գույք հանքային իրավունքների նկատմամբ՝ օրենքով սահմանված կարգով կնքված գրավի կամ գրավի պայման պարունակող պայմանագրերից ծագող գրավի իրավունքները, ինչպես նաեւ անհատապես որոշվող՝ օրենքով սահմանված կարգով լիզինգի պայմանագրի առարկա հանդիսացող շարժական գույքի նկատմամբ կնքված լիզինգի պայմանագրերից ծագող վարձակալության իրավունքները:

rights to obtain satisfaction from the value of the pledged property towards the creditors having registered their rights later or those who have not registered their rights at all⁸. One of the most important articles of the Law is Article 12 -“*Documents Subject to Submission for Registration*” which sets the exhaustive list of the documents needed for registration of the right of pledge including (i) the application - the form of which is approved by the body carrying out the registration, (ii) applicant’s identification documents as stipulated by the legislation of the Republic of Armenia, and, in case of a proxy for registration - the documents substantiating his/her authorities standing as the proxy, (iii) the copy of the contract of pledge over movable assets and documents proving the fact of payment of registration fee. The same article also stipulates that the documents for registration may be submitted to the body carrying out registration by applicant or an authorized person personally or by mail and prohibits requiring any document other than those specifically mentioned therein⁹. Article 13 entitled as “*Time Periods for Submission of Application for Registration of the Right of Pledge and for Registration*” provides that the right of pledge over movables can be registered during the whole validity period of the pledge contract and that the registration is carried out and the pledge certificate is issued during the next business

⁸ «Շարժական գույքի կադաստրի վարման, շարժական գույքի գրավի իրավունքի, լիզինգի պայմանագրով վարձակալության իրավունքի գրանցման մասին» ՀՀ օրենք,

Հոդված 10. Շարժական գույքի գրավի իրավունքի գրանցման իրավական հետևանքները

1. Առավել վաղ գրանցված իրավունք ունեցող գրավառուն ավելի ուշ գրանցված իրավունք ունեցող գրավառուների եւ գրանցված իրավունք չունեցող գրավառուների հանդեպ գրավ դրված գույքի արժեքից լրիվ ծավալով բավարարում ստանալու նախապատվության իրավունք ունի:

⁹ «Շարժական գույքի կադաստրի վարման, շարժական գույքի գրավի իրավունքի, լիզինգի պայմանագրով վարձակալության իրավունքի գրանցման մասին» ՀՀ օրենք

Հոդված 12. Գրանցման համար ներկայացվող փաստաթղթերը

1. Շարժական գույքի նկատմամբ գրավի իրավունքի գրանցման, փոփոխության, դադարման եւ դադարեցման համար դիմողն անձամբ, փոստով կամ այլ անձանց միջոցով (եթե դիմումում դիմումատուի ստորագրության իսկությունը վավերացված է օրենքով սահմանված կարգով) կամ իր լիազորած ներկայացուցչի միջոցով, գրանցումն իրականացնող մարմնի հաստատած դիմումի ձեւաթղթի լրացմամբ, անկախ գույքի գտնվելու վայրի՝ կենտրոնացված գրանցման դեպքում գրանցումն իրականացնող մարմնին ներկայացնում է դիմում:

5. Դիմողը պետք է ներկայացնի Հայաստանի Հանրապետության օրենսդրությամբ սահմանված՝ անձը հաստատող փաստաթղթեր, իսկ լիազորված լինելու դեպքում՝ նաեւ լիազորությունները հաստատող փաստաթուղթ: Դիմումին կից ներկայացվում են շարժական գույքի գրավի պայմանագիրը եւ վճարի անդորրագրերը:

day following the day of application¹⁰. The next important articles of the Law are article 14-
“Registration of Right of Pledge over Movable Property”¹¹, providing that (i) upon
submission of the documents the authorized body should give a receipt to the applicant
containing the information on the date, hour and minute when the application was accepted
and the list of documents received, (ii) in case of registration of the right the respective entry
is being made in the registry and a pledge certificate in the form approved by the authorized
body is issued, and article 20 entitled “The Grounds for Rejection of the Registration of the
Right of Pledge over Movable Property”¹² which states the comprehensive list of grounds
allowing the registration to be rejected. According to article 20 the authorized body rejects
the registration in the following cases (i) the requirements stated in the article 12 regarding
the content of the application are not preserved, (ii) the applicant is not a subject of

¹⁰ «Շարժական գույքի կադաստրի վարման, շարժական գույքի գրավի իրավունքի, լիզինգի պայմանագրով վարձակալության իրավունքի գրանցման մասին» ՀՀ օրենք

Հոդված 13. Շարժական գույքի գրավի իրավունքի գրանցման համար դիմումի ներկայացման և գրանցման ժամկետները

1. Սույն օրենքով նախատեսված պայմանագրերից ծագող իրավունքի գրանցման դիմումը կարող է ներկայացվել գրավի պայմանագրի գործողության ժամկետի ընթացքում՝ ցանկացած ժամանակ, եթե օրենքով այլ բան նախատեսված չէ:

2. Գրավի իրավունքի գրանցումն իրականացվում, եւ գրավի վկայականը տրվում է դիմումը ներկայացնելու օրվան հաջորդող աշխատանքային օրվա ընթացքում:

¹¹ «Շարժական գույքի կադաստրի վարման, շարժական գույքի գրավի իրավունքի, լիզինգի պայմանագրով վարձակալության իրավունքի գրանցման մասին» ՀՀ օրենք

Հոդված 14. Շարժական գույքի գրավի իրավունքի գրանցումը

1. Գրանցումն իրականացնող մարմինը գրավի իրավունքի գրանցման դիմումը ստանալուց հետո դիմողին տալիս է ստացական, որտեղ նշվում է դիմումի ներկայացման տարեթիվը, ժամը, լուսնի և ներկայացված փաստաթղթերի անվանումները, դիմումի մուտքագրման հերթական համարը: Ստացականի ձեռք սահմանում է լիազոր մարմինը:

2. Գրավի իրավունքը գրանցելու դեպքում գրանցման մատյանում իրականացվում է համապատասխան գրառում՝ նշելով պայմանագրում առկա՝ սույն օրենքով սահմանված տեղեկությունները, եւ դիմողին տրամադրվում է գրավի իրավունքի գրանցման վկայական, որի ձեռք սահմանում է գրանցումն իրականացնող լիազոր մարմինը:

¹² «Շարժական գույքի կադաստրի վարման, շարժական գույքի գրավի իրավունքի, լիզինգի պայմանագրով վարձակալության իրավունքի գրանցման մասին» ՀՀ օրենք

Հոդված 14. Շարժական գույքի նկատմամբ գրավի իրավունքի գրանցման մերժման հիմքերը

Գրանցումն իրականացնող մարմինը մերժում է գրավի իրավունքի գրանցումը, եթե՝

1) չի պահպանվել սույն օրենքի 12-րդ հոդվածում սահմանված դիմումի բովանդակությանը ներկայացված պահանջը.

2) դիմողը չի հանդիսանում սույն օրենքի 7-րդ հոդվածով նախատեսված գրանցման սուբյեկտ.

3) չեն ներկայացվել սույն օրենքի 12-րդ հոդվածով սահմանված փաստաթղթերը.

4) փաստաթղթերը ներկայացվել են մատիտով գրված, ջնջումներով կամ ուղղումներով:

Արգելվում է այլ պատճառներով գրանցման մերժումը, այդ թվում՝ աննպատակահարմարության պատճառաբանությամբ:

registration mentioned in article 7 of the Law, (iii) the documents specified in article 12 of the Law have not been provided, and (iv) the documents were filled in by pencil or with corrections. The article prohibits rejection of registration on any grounds other than those mentioned in the Law.

As to other legal acts regulating the registration of the right of pledge it is worth mentioning the Resolution of the Government of the Republic of Armenia No 1678-N dated 29 October 2004 “On Granting Authorities to Maintain the Cadastre of Movable Property , To Register the Right of Pledge, The Right of Lease Arising Out From The Contract of Lease Over Movable Property ”¹³ according to which the authority to carry out the registration of the right of pledge over movables is transferred to the State Committee of Real Estate Cadastre under the Government of the Republic of Armenia. The following legal acts also are to be mentioned:

- The Order of the Chairman of the State Committee of Real Estate Cadastre No 250-N dated 08 November 2004¹⁴ which among others approved the forms of movable property pledge certificates, receipts and applications for registration,
- The Order of the Chairman of the State Committee of Real Estate Cadastre No 6-N dated 19 January 2005¹⁵ delegating the authority to register the right of pledge over movables to “Kentron” territorial sub-division of the State Committee of Real Estate Cadastre, and

¹³ Resolution of the Government of the Republic of Armenia No1678-N (adopted on 29 October 2004, published on 27.12.04 RA Official Bulletin No 71),

¹⁴ Order of the Chairman of the State Committee of Real Estate Cadastre No 250-N (issued on 08 November 2004, published on 17.12.04 RA Bulletin of Departmental Normative Acts No 176),

¹⁵ Order of the Chairman of the State Committee of Real Estate Cadastre No 6-N (issued on 19 January 2005, published on 15.02.05 RA Bulletin of Departmental Normative Acts No 4),

- The Order of the Chairman of the State Committee of Real Estate Cadastre No 7-N dated 19 January 2005¹⁶ approving the procedure of business correspondence between the territorial sub-divisions of the State Committee of Real Estate Cadastre related to registration of the right of pledge over movable property.

There are a number of issues arising in the process of registration of the right of pledge. Taking into consideration the fact that currently in Armenia the applications for registration of the rights of pledges of banks and other credit organizations engaged in the lending activity (both consumer and commercial) are comprising overwhelming majority in total amount of applications submitted for registration (approximately 95%)¹⁷, the examples of the most common problems arising in the process of registration were presented by the representatives of HSBC Bank Armenia CJSC, one of the biggest banks operating in Armenia and Norvik Universal Credit Organization CJSC, one of the leading credit organizations in Armenia. Both respondents identify the violation of the terms stipulated by the law for registration as the main issue being faced during the process of registration. The pledge certificates are issued in three-four business days instead of one specified by the law. This was crucial in the case of registration of the right of pledge of HSBC Bank Armenia over a vehicle to be bought by one of the customers the name of which the representative of the bank refused to disclose. The registration of the right of pledge lasted four business days, which led to termination of the contract, since the seller in this particular case didn't wait for such a long time sold the vehicle to another buyer. Officers of Kentron sub-division of Real Estate Cadastre said the reason for the delay was the overloaded workflow of the cadastre. However, this reason has not been documented.

The next group of issues is related to unsubstantiated rejections of registrations where the creditors (applicants) are non-resident natural or legal entities. In the case of Blue Sky

¹⁶ Order of the Chairman of the State Committee of Real Estate Cadastre No 7-N (issued on 19 January 2005, published on 15.02.05 RA Bulletin of Departmental Normative Acts No 4),

Limited, where a non-resident company applied for the registration of the right of pledge over an aircraft, the registration was rejected based on (2)(sec2) Article 20 of the Law “On Maintenance of Movable Property Cadastre, on Registration of the Right of Pledge and Leasing over Movable Property” which states that the applicant is not the subject of civil-law relationships as required by the law. Only when the case was brought to the attention of the higher instance (Chairman of the State Committee of Real Estate) with the substantiation that foreign entities and individuals are also equal subjects of civil-law relationships as those of the Republic of Armenia, was the case resolved.

The presented examples are not supported by court cases. Both practitioners interviewed assume that the reason why the cases are not being brought before court is that in fact the current registration mechanism offers little protection to creditors and though these issues cause delays in the registration process, litigations before courts will perhaps cause even more delays and consume more resources. Besides, as mentioned by both interviewed persons, though the concept of registration of the right of pledge over movables was implemented with the aim to introduce a new, more advanced level in protection of creditors’ rights, in fact it brought little changes in this respect. To some extent, the creditors still remain unprotected, since the registration ensures only priority rights for creditors, but does not, for example, create legal mechanisms to prevent the alienation of the pledged property without the consent of creditors.

The main steps for registration of the right of pledge over movable property described below represent the transaction based on the Civil Code and the Law “On Maintenance of Movable Property Cadastre and On Registration of the Right of Pledge and Leasing over Movable Property” as amended through June 2007 and the information received from interviewed persons Mr. A. Kotolkyan, a private entrepreneur currently providing services

¹⁷ The information was provided by Vahagn Rostomyan, Movable Property Registration Officer, Kentron sub-division of State Committee of Real Estate Cadastre.

related to registration of rights of pledges and pledges to HSBC Bank Armenia CJSC, Mr. A.Teryan, Head of Lending Department of Norvik UCO CJSC and Mr.Vahagn Rostomyan, Movable Property Registration Officer of “Kentron” sub-division of State Committee of Real Estate Cadastre. The steps are as follows:

1. Signing of a pledge contract. As provided by the Civil Code of the Republic of Armenia the pledge contract over movable property is to have a simple written form. Notarization of the contract is not required. However, currently the creditors still notarize the contracts to avoid unnecessary problems related to the process of identifying whether the particular person/entity is the owner of the pledged property or not.
2. Submission of a copy of pledge contract and the copy of the passport of the applicant to a territorial sub-division of the State Committee of Real Estate Cadastre. The applicant should fill in the respective application form available in hard copies at the respective sub-division of Real Estate Cadastre¹⁸. If the applicant is a representative of one of parties to the contract, then he/she should also submit the genuine Power of Attorney. The document substantiating the payment of the registration fee should also be attached to the set of documents. Though the registration is carried out in a centralized manner by “Kentron” sub-division of the State Committee of Real Estate Cadastre, the documents can be presented to any territorial office. Then, during the same business day, the copies of presented documents and filled in application are forwarded to “Kentron” sub-division via fax, e-mail or telex.
3. “Kentron” sub-division of Real Estate Cadastre upon submission of the documents issues a receipt which specifies the set of the documents submitted and the date, time and cases the receipt is not issued for one reason or another.

¹⁸ The samples of the applications are also available on-line at www.sharj.cadasrte.am.

4. During the next business day “Kentron” sub-division of Real Estate Cadastre registers the right of pledge by making respective entries in the registry and issues the pledge certificate, if no grounds for rejection of registration are identified.

Except the afore-mentioned steps which are stipulated by the legislation, there are two more which are not specifically mentioned in the legal acts but widely practiced by creditors. Where the movable property subject to registration, before entering into a transaction involving pledge an acknowledgement is obtained from the body registering the particular asset that no encumbrances exist in respect of the asset (e.g. the asset is not under arrest, etc.) and a notice is sent to the same body that the creditor possesses security interest in a particular asset.

3. INTERNATIONAL BEST PRACTICE

In this section a summary of key features of international best practice with respect to regulation of registration of security interest in movable assets will be presented. The summary is based on research and comparative analysis of the respective legislations of the United States of America, England, Lithuania and Ukraine.

Common law and civil law jurisdictions differ in their approach on creating guarantees for creditors enjoying security interests in movable assets. For instance, the legislation of the United States considers the security rights of the creditors in movable assets of the debtor to get priority against the interests of third parties when such rights/interests are perfected, i.e. can be enforced against other creditors of the debtor either by possession or by filing. From these two the filing method of perfection, when the perfection is achieved through filing a notice to a respective public office is the one that by some of its features resembles the continental security interest registration system.

The procedure and main features of perfection of security interests by notice filing is regulated by Article 9 of the Uniform Commercial Code (UCC) which sets that for perfection of security interests in movable property the creditor needs to file only a simple notice (financing

statement) and not the security agreement itself to a public office. This notice itself indicates merely that the secured party who has filed may have security interest in the collateral described.¹⁹ Article 9 provides for three alternatives for the places where a financing statement can be filed, being (i) central filing at a single public office (Secretary of State at the state capital), (ii) local filing at a local county or township office, where the debtor resides, and (iii) local filing at a local county or township office, where the collateral is kept²⁰. Though Article 9 of the UCC doesn't stipulate a universal form for financing statements, it sets what minimum information the latter should contain. In particular, it should reflect at least the following: (a) the names of parties, (b) the address of the secured party, from which the information concerning the security interest may be obtained, (c) the description of the items of collateral. The UCC doesn't have any provision requiring filing within specified period of time, assuming that the creditors themselves should be interested in prompt filing as the delays may result in losing of preference to recover their debts from the value of the pledged movables.

The legislation of England like the legislation of the US recognizes the perfection of security interests in movables by filing. In the meantime English law provides also that charges²¹ (pledges) created by companies are subject to registration. It is worth mentioning that the registration requirement, in general, applies to companies only. The only security interests created by individuals requiring registration are mortgages over movables under bills of sale legislation.²² The charge must be registered at the Company Registry within 21 days of its creation. The legal consequence of none-registration is that the security interest becomes void against other creditors. A significant difference between the English system and UCC Article 9

¹⁹ Henry J. Baily III & Richard Hagedorn "Secured Transactions in a Nutshell", St.Paul,Minn, West Publishing Co, 1988, p. 144

²⁰ Henry J. Baily III & Richard Hagedorn "Secured Transactions in a Nutshell", St.Paul,Minn, West Publishing Co, 1988, p. 145

²¹ "Charges" includes any form of security interest other than one arising by operation of law (Philip R Wood "Comparative Law of Security and Guarantees", London, Sweet & Maxwell, 1995, p. 133)

²² Philip R Wood "Comparative Law of Security and Guarantees", London, Sweet & Maxwell, 1995, p. 131

is that the English method does not establish a priority system and is aimed only to act as a notification to other creditors dealing with the company.

The registration of security interests in movables in Lithuania is governed by the Civil Code of Lithuania of 2001 and the Code of Civil Procedure of 2003. The registration of security interests in movables in Lithuania is carried out in a centralized way. The Civil Code provides that all non-possessory charges over movable property are registered with a single institution – the Hypothecary Register, which is operated by the state. The Hypothecary register consists of the Central Hypothecary Office and Hypothecary divisions that are parts of the general competence courts of first instance. The registration of charges over movable property is conducted by Hypothecary judges. Though the registration of security interests over movables is carried out by one institution, there are differences in the procedures of registration of charges and so called quasi security interests.²³ For registration of charges over movable property the actual documents evidencing the transaction should be filed to the Hypothecary Registrar, that is the formal charge deed certified by the public notary. In contrast, to register quasi security interest, filing of a notice to the Hypothecary Registrar is sufficient. The requirements for the content of the notice is almost the same as provided by UCC Article 9. The major consequence of the filing of a non possessory charge is its creation, i.e. the charge becomes legally binding, while the registration of the quasi security interest merely perfects the creditors' rights. Finally, in case of registration of quasi security interests the role of the registration officer (Hypothecary judge) is restricted to a managerial one, while in the case of registration of charges the registration officer must ensure that the entire transaction is concluded in accordance with the requirements of the respective legal acts²⁴.

²³ “Quasi security interests” are security interests created by the contract of leasing, installment sale, etc. (“Reform of Security Over Movable Property in Lithuania, the Second stage”, an article by Andrius Smaliukas, PhD fellow at the law faculty of Vilnius University; Law in Transition, April 2004, <http://www.ebrd.com/pubs/legal/series/lit>.)

²⁴ “Reform of Security Over Movable Property in Lithuania, the Second stage”, an article by Andrius Smaliukas, PhD fellow at the law faculty of Vilnius University; Law in Transition, April 2004, <http://www.ebrd.com/pubs/legal/series/lit>

In Ukraine, both the substantive and procedural issues related to registration of security interests over movables are regulated by the Law on Securing Creditors' Claims and Registration of Encumbrances entered into force on 01 January 2004. The Ukrainian law like the law regulating the same relationships in the Republic of Armenia, sets that the registration of security interests over movables shall only guarantee the priority of registered rights towards those that were not registered, but does not affect the creation of those interests. At the same time the law extends higher protection standard to registered security interests over movable property created on the basis of the installment sale agreements stating that these interests enjoys priority against any other registered security interests even if the latter were registered earlier. The registration of the right of pledge/security interest is carried out in a centralized way, on the basis of an application which shall reflect at least the following information: (a) the names, addresses and other data on parties, (b) information on the grounds upon which security interest is based, the size of the secured obligation and maturity term, (c) description of the item of movable property in which the security interest is held, (d) information on a ban or restriction on debtor's right to alienate the collateral. Thus, unlike the Armenian law, the Ukrainian law gives a possibility to restrict the owner's right to alienate the property, which is, in fact, a higher level of protection of creditor's right in comparison with the one which the Armenian law is capable of providing. Besides, the registration here, is implemented on the basis of a single application and no additional document need be presented (including a copy of pledge agreement).

In general, as we can infer from the topics discussed above the security registration systems operating in both common law and civil law jurisdictions are accomplishing the objectives of registration. Of course, there are some substantive and procedural differences in the manner registration is carried out in different countries which can be explained by differences in the existing legal traditions of those countries. Differences can also be explained by developed countries vs. developing countries approach.

4. PROCEDURE EVALUATION

The policy behind the regulation of the registration of the right of pledge is to create protection mechanisms of creditor's rights by making them known to other potential creditors of the debtor. The Guiding Principles for the Development of Charges Registry developed by the European Bank for Reconstruction and Development²⁵ (EBRD) state some principles which should be implemented for a registration system to operate efficiently. A few which are more relevant to the subject of this paper, are listed below:

- Effective publicity system. A publicity system can operate effectively if (i) it is simple fast and easy for all parties to use, (ii) it supports the needs of whole credit sector, (iii) the market is willing to use the publicity system, (iv) the system actually enables the public to become aware of the charges which exist.

The existing system of registration of rights over movables in Armenia generally satisfies the above efficiency criteria, except the one mentioned under (iii). As discussed earlier in this paper, the general approach to the system of registration of the right of pledge in Armenia is that the market considers it rather formal legal step which is, in fact, incapable of extending real protection to the rights of creditors over the movable assets of the debtor.

- As a result of publicity it should be possible to find out what charges are claimed over a person's assets and their chronological order of ranking. The Law of the Republic of Armenia "On Maintenance of Movable Property Cadastre, on Registration of the Right of Pledge and Leasing over Movable Property" (hereinafter: the Law) generally provides for mechanisms of determining the chronological order of ranking of charges over movable assets of debtor, in particular Article 15 of the law stipulates that the register of

²⁵ Publicity of Security Rights – Guiding Principles for the Development of a Charges Registry, European Bank for Reconstruction and Development, 2004, <http://www.ebrd.com>

the pledges should contain information of the date, hour and minute when the respective registration was made.

- Failure to publicize a charge makes it ineffective against third parties. In some legal systems publicity is a condition for the creation of a security interest over movables, in others (including Armenia) a creditor with registered right of pledge acquires only prior ranking against other creditors.

Theoretically a notice- registration system, which is intended to merely perfect security interest and to notify any third parties that the pledge/creditor might claim a security interest in the pledged movables is more modern than the so-called document filing based systems, where the filing mechanisms are more bureaucratic and time and resource consuming. In any case, to evaluate the operation of the security interest registration system the issue whether it adequately serves the needs of the parties when entering into transaction involving the pledge of movables needs to be clarified.

In this regard the current registration system of Armenia has not been functioning soundly. Though the registration itself seems to be attractive as it functions fairly quickly, the registration fees are affordable and the system is operated in a centralized manner. The creditors (in particular the institutional lenders) use the registration only as a formal guarantee of their security interests in pledged movable assets. One of the major shortcomings of the Law is that unlike the laws of other countries employing similar registration systems (e.g. Ukraine) it does not prohibit the owner of a pledged movable asset to alienate the pledged property without the consent of the creditor. This is the main reason why the creditors consider the current registration mechanism not to be capable of providing real protection of their interests. The other problematic issue hindering the sound functioning of the current registration system is that it provides the possibility to register the right of pledge over limited items of movable property specifically mentioned in the Law. The pledge rights over movable assets other than those mentioned in the law are not subject to registration. Another factor affecting the effectiveness of

the registration system is that it doesn't stipulate any differences in publicizing the security interests and so-called "quasi security interests"²⁶. This makes transactions like financial leasing and installment sale, which are very widely used in other countries, less attractive by making them unreasonably burdensome and creating too many formalities to be complied with by the potential creditors.

5. REFORM RECOMMENDATION

As it was previously mentioned the main problems related to creating guarantees for creditors through registration of the right of pledge over movables are: (a) lack of general willingness from the side of participants in the market to use the registration due to incapability of the latter to extend sufficient level of protection, (b) absence of notice-filing system for publicizing "quasi" security interests as described above in parallel with the existing document based registration system of pledges.

a) In its current edition the Law does not set any prohibition for the owners of pledged movable assets to dispose the pledged property in any manner, i.e. to sell, pledge or otherwise alienate the pledged property without the consent of creditors(charge holders).By contrast, the Law of the Republic of Armenia "On State Registration of Rights over Property"²⁷ which deals with the issues of registration of rights over immovable property stipulates that after the registration of rights of pledge or mortgage a restriction is applied to the property and no other document being in contradiction with the registered right of pledge/mortgage may be registered without the consent of the creditor²⁸. Taking into consideration the fact that according to the law

²⁶ See Supra footnote 23

²⁷ The Law of the Republic of Armenia on State Registration of Rights Over Property (adopted on 14.04.1999, enacted on 06.05.1999, published on 06.05.1999)

²⁸ « Գույքի նկատմամբ իրավունքների պետական գրանցման մասին » ՀՀ օրենք

Հոդված 28. Գրավի, հիփոթեքի առարկա հանդիսացող գույքի սահմանափակումը (արգելադրումը)

all the rights over immovable property are subject to registration to become effective, the alienation as well as any other transaction with the pledged/mortgaged item of immovable property without the consent of the creditor is impossible. A similar mechanism can be employed when the rights of pledge over movable assets are registered. This will perhaps require also the unification of charges registry (where the rights of pledge are registered) with the cadastre of movable assets (a registry where items of movable assets subject to registration, in accordance with the Law such as vehicles, machinery, aircrafts, etc. are to be registered). These two registries currently are operated by different institutions and the unification will lead to maintenance of the registries by one institution. In this case the registration of security interest over movables may become a legally effective measure, capable of serving the interests of the parties of the transaction.

b) Currently the Law provides for registration of rights of pledge only over limited types of movable assets, which can be successfully identified by some features, such as Vehicle Identification Numbers for vehicles, registration numbers for machinery, etc, thus making impossible the registration of security interests in other items of movable assets. The introduction of a notice-filing system of publicizing the rights of creditors in movable assets, will enable to prioritize even the security interests in movable assets not capable of being identified by registration or other unique numbers, e.g. consumer goods, equipment, etc. Besides, the notice-filing system of registration will also allow to have less burdensome procedure of prioritizing the “quasi security” interests.

6. CONCLUSION

Գրավի, հիփոթեքի իրավունքի գրանցումից հետո գույքի նկատմամբ սահմանված կարգով կիրառվում է սահմանափակում (արգելադրում): Արգելադրման կիրառման կարգը սահմանում է անշարժ գույքի պետական ռեգիստրը: Գրավի, հիփոթեքի գրանցման ընթացքում դրան հակասող փաստաթուղթ, առանց գրավառուի համաձայնության, չպետք է գրանցվի:

The main objectives of this paper were the evaluation of the procedure of registration of security interests in movables as one of the methods of creation of guarantees for creditors, the assessment of the extent of reconciliation of the existing procedures with the public policy requirements, the comparison of the system of registration functioning in Armenia with those of other countries and proposing of reforms in order to fill in the gaps in the system.

From the first sight, the current legal framework regulating the event created a system of registration of the rights of pledge in movable assets capable of providing priority to the creditors registered their rights. However, the research of the functioning of the system revealed some shortcomings hindering to meet the policy requirements. One of the problematic issues is the absence of possibility to restrict the disposal of the pledged movable property by the owner, which render the registration a formal step. To reform the situation it was recommended to employ the same approach as is done for registration of the charges over immovable property, i.e. not to allow any transaction with the pledged item of movable assets without the consent of the creditor. Another problem creating obstacles for efficient operation of registration system is the limited number of movable assets the security interest over which may be registered and one method of registration for both security and “quasi security” interests, making the latter procedure unreasonably burdensome and less attractive. It was recommended to introduce the notice-filing system of publicizing as a method to prioritize the creditors’ security interests by filing a statement to other potential creditors and for registration of “quasi security” interests. Irrespective the mentioned problems the registration system in its current shape is capable of publicizing the creditor’s rights in pledged movable assets and enables the potential creditors to obtain information on encumbrances over the asset before entering into secured transaction.

Hopefully, the implementation of the mentioned recommendations above will move the system of registration of the right of pledge one step forward in the way of achieving the policy objectives, i.e. creating effective guarantees of protection of creditors’ rights.

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ATTACHMENT A

The Civil Code of RA

Article 226. Definition of the Right of Pledge

1. The right of pledge (hereinafter--“pledge”) is a property right of a pledgee with respect to property of the pledgor, which simultaneously is a means of ensuring the performance of a monetary or other obligation of the debtor to the pledgee.

Article 226. Definition of the Right of Pledge

3. A creditor under an obligation secured by a pledge (a pledgee) has the right in case of nonperformance by a debtor of this obligation to obtain satisfaction from the value of the pledged property preferentially before other creditors of the person to whom this property belongs (the pledgor). A pledgee having registered the right arising out from the contract of pledge in the register of charges maintained by authorized body earlier has the right to obtain satisfaction from the value of the pledged property preferentially before the pledgees registered the rights arising out from the contracts of pledge later or not registered them at all.

Article 234. The Contract of Pledge and Its Form

1. A contract of pledge must be concluded in written form.
2. A contract of pledge must indicate the name (or designation) and place of residence (or place of location) of the parties, the subject of the pledge, the nature, amount, and period for performance of the obligation secured by the pledge.

The Law of the Republic of Armenia “On Maintenance of Movable Property Cadastre, on Registration of Rights of Pledge and Leasing Over Movable Property”

Article 6. Object of Registration

1. For the purposes of this Law the object of registration are the lease rights with respect to moveable property and property rights arising from pledge and lease agreements.
2. The objects of registration are the pledge rights arising from pledge agreements or such agreement containing terms of pledge signed in accordance with the procedure provided in the law and relating to vehicles, self-propelled vehicles, machines, equipment, flying and swimming devices and the components thereof which can be qualified as specific property as to mining rights, as well as specific lease rights arising from lease agreements relating to movable property being the subject of the lease agreement.

Article 10. Legal Consequences of Registration of Movable Property Pledge

1. The creditor having registered the right of pledge earlier enjoys preferential right over the creditors registered their rights later and the creditors not registered their rights to get satisfaction from the value of pledged property.

Article 12. Documents Submitted for Registration

1. For the purpose of registration of the right of pledge, change, termination of such right the applying persons shall submit to the registering body by hand, by mail or through other persons (if the authenticity of the applicant’s signature has been verified in the application in accordance with the procedure provided in the Law) or other authorized representative an application in the approved format.
5. The applicant must submit proper identification documents as stipulated under RoA legislation, and in case of an authorized representative- a proper authorization document. Moveable property pledge agreement and payment cheque are attached to the application.

Article 13. Term of Submission of Application for Registration of Moveable Property Right and Registration.

1. The application for registration of the rights arising from the Agreements stipulated under this Law may be submitted any time during the term of validity of the pledge agreement, unless otherwise provided under the Law.
2. The right to pledge is registered and the pledge certificate is provided on the next working day following the submission of the respective application.

Article 14. Registration of the Moveable Property Pledge Right

1. Upon accepting the application the authorized registering body shall provide to the applicant a receipt containing information on the date, hour, minute of submission as well as the names of documents enclosed to the application and the regular number of the application. The form of the receipt is approved by the registering body.
2. In case of registration of the right to pledge respective records are made in the registration book mentioning the information contained in the agreement as provided for in the Law and provides to the applicant pledge right registration certificate which form is approved by the authorized registering body.

Article 20. Grounds For Refusing Registration of the Pledge Right with Respect to Movable Property

The authorized registering body shall waive the registration of the respective pledge right, if:

- 1) the requirement stipulated under Article 12 of the Law relating to the contents of the application has not been complied with,
- 2) the applicant does not appear to be the object of registration as provided in Article 7 of the Law,
- 3) the documents stipulated under Article 12 of the Law have not been provided,
- 4) submitted documents are written with a pencil or there are corrected or erased data.

The registration may not be refused for other ground whatsoever, including due to inexpediency.

Law of RoA on State Registration of Rights with respect to the Property

Article 28. Putting Hold over pledged property

After registration of the right to pledge a restriction shall apply to the respective property according to the fixed procedure. The procedure of applying restriction is defined by the real estate state register. In the process of registration of the right to pledge no document to the contrary shall be registered except with the consent of the pledgor