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SECURED CREDIT AND INSOLVENCY LAW IN ARGENTINA AND THE U.S.: GAINING INSIGHT FROM A COMPARATIVE PERSPECTIVE*

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INTRODUCTION: REASONS FOR A COMPARATIVE STUDY

Writing in 1787 to urge ratification of the U.S. Constitution, James Madison identified the conflicting interests of the debtors and creditors as a principal source of faction. Recognizing that the regulation of "various and interfering interests" such as those of debtors and creditors "forms the principal task of modern Legislation," Madison argued that a republican form of government extending over a large geographic area could "refine and enlarge the public views," thus muting the impact of factional ideologies on the legislative process.[1] Whatever has been accomplished over the subsequent two centuries, laws defining the rights of debtors and creditors continue to be critical and controversial elements of the contemporary social fabric. The clash of interests is particularly acute when it comes to defining when creditors will have special privileges and when debtors can obtain relief or modification of their debts in bankruptcy or other insolvency proceedings. In recent years in the United States, this clash of interests has been most apparent in strident debate over legislation to amend the federal Bankruptcy Code to make it more difficult for individual debtors to file liquidation proceedings; and to make it easier for creditors to enforce security interests in consumer assets.[2] James Madison would not be surprised.

The new aspect of the controversy about law regulating debtor—creditor relationships, which Madison could not have foreseen, is that the debate is now conducted on the world stage. In an era of globalization, the legal order confronts the inexorable demands of the world market.[3] Every nation feels pressure to adapt its laws to allow its firms to compete internationally. The tensions globalization can produce are now manifested in efforts to change the

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[1] Madison's classic defense of the republican form of government appeared in *The Federalist No. 10*. *See The Federalist Papers*, at 44-49 (Alexander Hamilton) (Bantam Classic ed., 1982).

[2] Both houses of Congress passed bankruptcy legislation in 2000, but the bill was vetoed by President Clinton. Similar legislation has been passed by both Houses in 2001, but differences in the two bills have not been resolved. In light of economic uncertainties compounded by the attacks of September 11, final action on this legislation was delayed. All references in this paper are to the "Bankruptcy Reform Act of 2001," 107th Cong. (2001).

[3] Globalization is a multifaceted and controversial phenomena. We view the internationalization of commerce which has occurred since World War II simply as a historical fact. Goods, services, capital, information and people now move across national borders with more frequency and greater impact. The developments seem to have been spurred by changes in communications, transportation and information processing. They have also been supported by the prevailing political climate. No one knows whether and to what extent these trends will continue in the future.

laws of many countries regulating transactions secured by personal property.[4] For centuries both civil and common law jurisdictions suppressed non-possessory security arrangements in personal property. A pledge might be permitted, but it required some transfer of possession of the pledged assets to the creditor. Devices which allowed the debtor to possess and enjoy its assets while purporting to shield them from the claims of its common creditors were considered immoral and misleading. Even when commercial pressures forced piecemeal recognition of non-possessory security devices, that recognition came with insistence on formalities and restrictions.[5] Civil law nations like Argentina, are influenced by French law, and have been particularly hesitant about non-possessory personal property security.[6]

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[4] We recognize that "secured credit" is not a term commonly used in Argentina. For our definition of the transactions which qualify as "secured credit," *see* Parts I.*A* and B of this paper. Credit extended under Argentine *hipotecas* and *prendas* qualifies as "secured credit" as we use the term. As a result of the deep economic crisis which descended on Argentina in early 2002 emergency legislation suspended the enforcement of *hipotecas* and *predas* for 180 days beginning February 2, 2002. Ley 25.5673, art. 9. Also, the filing of *quiebras* proceedings (liquidation bankruptcies) was suspended for the same 180 day period. Ley 25.563, art. 11. This emergency moratorium legislation could be modified or lifted at any time. Its enactment at a critical time in Argentina underscores the importance of the issues discussed in this paper.

[5] The most authoritative description of the complex regulation of security devices under pre-Article 9 U.S. law is presented in 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY §§ 1.1 - 8.8 (1965). In a well-known passage, Professor Gilmore attempted to summarize the Anglo-American history: "Until early in the nineteenth century the only security devices which were known in our legal system were the mortgage of real property and the pledge of chattels. Security interests in personal property which remained in the borrower's possession during the loan period were unknown." *Id.* at 24. In a series of recent articles, Professor George Lee Flint, Jr. has challenged Gilmore's timeline, arguing that some earlier state decisions in the U.S. upheld chattel mortgages. However, Flint agrees that non-possessory interests were invalidated in England in bankruptcy; and that European law at the beginning of the 19th Century was hostile to them. *See* George Lee Flint, Jr., *Secured Transactions History: The Fraudulent Myth*, 29 N.M. L. REV. 363 (1999); *Secured Transactions History: The Impact of Textile Machinery on the Chattel Mortgage Acts of the Northeast*, 52 OKLA. L. REV. 303 (1999); *Secured Transactions History: The Northern Struggle to Defeat the Judgment Lien in the Pre-Chattel Mortgage Act Era*, 20 N. ILL. U. L. REV. 1 (2000).

[6] The Roman *hypotheca* was a non-possessory security device. However, the French Civil Code of 1804 expressed the European consensus at the beginning of the Nineteenth Century. The only personal property security device which it recognized was the *gage*. CODE CIVIL art. 2067 (Fr. 1804). For tangible personal property, Article 2067 of the French Civil Code declares "the priority subsists on the gage only to the extent that such gage was placed and remains in the possession of the creditor or of a third person agreed between the parties." C. CIV. art. 2067 (Fr. 1804). Professor Goode, the leading English scholar, summarizes the differences between civil common law jurisdictions as follows:

> First, there are wide differences in philosophy and legal culture concerning

The reasons for this traditional hesitancy are not hard to identify. Recognition of a "security interest" by its nature gives one person (the creditor) power over assets of another person (the debtor). Debtors typically have a strong psychological identification with assets which they own. In contemporary life, both the entrepreneur and the individual consumer think of their assets as precious possessions.[7] Our very identity tends to be bound up in what we own. It is difficult to underestimate the psychological dimensions of security devices. Collateral is valued by creditors precisely because it allows them to threaten to seize; and then (under local procedures) to seize and liquidate the collateral assets if the debtor does not pay. Security devices therefore afford powerful collection leverage. From a populist perspective, these devices provide strong power to a passive creditor who merely collects interest over a debtor who struggles to work and produce. Moreover, these arrangements are inherently preferential. They allow a debtor by agreement to assure one creditor will have a priority claim to the collateral assets to the exclusion of all other creditors. In Argentina and other countries, there has been fear that false and collusive claims of security will be asserted in order to obtain preferential treatment. Finally, security interests may cause third parties to be misled by the debtor's ostensible ownership of the collateral assets. The debtor in possession and enjoying assets that it does not own free

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> the extent to which security should be recognized at all and the conditions necessary for the validity of a security interest. Common law jurisdictions, which are generally sympathetic to the concepts of party autonomy and self-help, have a liberal attitude towards security. This attitude allows security interests to be taken with a minimum of formality over both present and future assets to secure existing and future indebtedness. In addition, they allow universal security rather than require specific security. By contrast, civil law jurisdictions have been more cautious in their approach to nonpossessory security and have been anxious about the "false wealth" which such practices are perceived as permitting. So in these jurisdictions one finds, in varying degrees, requirements of specificity or individualization of collateral, the need for a new post-acquisition act of transfer to give in rem effects to security in after-acquired property, requirements of notice to the debtor as a condition of *validity* (not merely priority) of an assignment of debts, and restrictions on self-help remedies such as possession and sale of the collateral.

Roy Goode, *Security in Cross-Borders Transactions*, 33 TEX. INT'L L.J. 47, 48 (1998). *See* PHILLIP R. WOOD, MAPS OF WORLD FINANCIAL LAW 8 (1997) (placing Argentina with Franco-Latino jurisdictions not generally sympathetic to security).

[7] *See* TOM WOLFE, A MAN IN FULL (1998). Mr. Wolfe's novel does not realistically describe the foreclosure process in the U.S., but it does capture how intensely his protagonist, Charlie Croker, wants to hold on to the "toys" of the rich man, e.g. his private jet, his quail farm.

and clear may give the impression of "false wealth."[8] A decisive breach with these concerns about personal property security was made in the U.S. with the adoption of Article 9 of the Uniform Commercial Code.[9] Article 9 embraces a generic "security interest" which may cover all types of personal property and which is extensively relied on to provide financing for consumers, farmers, investors, and small to medium size commercial enterprises.[10]

The Article 9 approach to personal property security has been adopted in the English—speaking provinces of Canada[11] and in New Zealand.[12] In 2000 Mexico, faced with competing with U.S. and Canadian firms under NAFTA umbrella, announced major changes in its secured credit and insolvency laws.[13] The European Bank for Reconstruction and Development (EBRD) presses for "reform" of secured transactions law along U.S. lines—particularly in the countries of Eastern Europe attempting the transition to free market economies.[14] A similar campaign is underway in Asia under the sponsorship of the Asian Development Bank (ADB).[15] Experts working auspices of Organization of American States (OAS) have discussed a Model Inter-America Law on

[8] Common law countries tend today to think of the problem of "ostensible ownership" as being solved by filing requirements. Civil law authorities that speak of the same problem as involving "false wealth" are less convinced that filing is a solution. They may doubt that a public registry can operate efficiently to provide notice of interests to third parties.

[9] Article 9 was first proposed in 1952 as part of the original U.C.C. by its sponsoring organizations, the American Law Institute and the National Conference of Commissioners on Uniform State Laws. In 1998 the U.C.C. sponsors proposed a new "Revised Article 9" which has since been enacted by all U.S. states. All references in this paper are to Revised Article 9.

[10] For an overview of how Article 9 operates see Part I.*C.4* of this paper. Large, "publically-held" corporations normally raise their funds in the securities market or through unsecured financing. They do not need—nor typically want—"floating lien" financing under Article 9.

[11] *See* Ronald C.C. Cuming, *Article 9 North of 49: The Canadian PPS Acts and the Quebec Civil Code*, 29 LOY. L.A. L. REV. 971 (1996).

[12] *See* Henry Deeb Gabriel, *The New Zealand Personal Property Securities Act: A Comparison With the North American Model for Personal Property Security*, 34 INT'L LAW. 1123 (Winter 2000).

[13] *See* Patrick Del Duca & Rodrigo Zamora Etcharren, *Mexico's Secured Lending Reforms*, 33 UCC L.J. 225 (2000).

[14] *See* John Simpson & Joachim Menze, *Ten Years of Secured Transactions Reform*, *Law in Transition* 20 (Autumn 2000). For a survey of the EBRD's results *see* Duncan Fairgrieve & Mads Andenas, *Securing Process in Collateral Law Reform: the EBRD's Regional Survey of Secured Transactions Law*, *Law in Transition* 28 (Autumn 2000).

[15] *Secured Transactions Law Reform in Asia: Unleashing the Potential of Collateral*, Law and Policy Reform at the Asian Development Bank, ABD Vol. II (2000) (emphasizing the importance of secured transactions for small and medium sized enterprises [hereinafter ADB Study].

Secured Transactions, which may be presented to legislative bodies in Latin America.[16] The United Nations Commission on International Trade Law (UNCITRA) is considering its own secured transaction project beyond its draft Convention on Assignment of Receivables.[17] Collectively, these efforts seek a global "reception" of the principles of U.S. personal property security law.

All these efforts to sell Article 9 principles to the world are supported by what has become a standard economic analysis. Scholars in the law and economics movement argue that Article 9, by allowing cheap and effective security, "turns on the money." In their view, it leads financers to provide more money and to provide it more cheaply.[18] By comparison, these scholars urge, systems such as those of Argentina restrict financing and make it more expensive by discouraging personal property security arrangements.[19] Only

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[16] *See generally Meeting of OAS—CIPIP-VI Drafting Committee on Secured Transactions*, 18 ARIZ. J. INT'L & COMP. L. 311 (2001). *See* John M. Wilson, *Secured Financing in Latin America: Current Law and the Model Inter-American Law on Secured Transactions*, 33 UCC L.J. 46 (2000) (commenting on earlier draft).

[17] *Security Interests*, United Nations Commission on International Trade Law, 34th Sess. U.N. Doc. A/CN. 9/496 (2001). We are indebted to Professor Franco Ferrari for calling this project to our attention. At the same time that these efforts to "reform" domestic laws are underway, there is a parallel effort to develop international conventions which facilitate international secured finance. Notable in this regard are the UNCITRAL Convention on Assignment of Receivables Financing and the UNIDROIT effort on a Convention for International Interests in Mobile Equipment.

[18] *See* Heywood Flesig, *Secured Transactions: The Power of Collateral*, *in* PUBLIC POLICY FOR THE PRIVATE SECTOR WORLD BANK (Apr. 1995) (in industrial countries moveable property can represent one-third of capital stock and half of investment); Jane K. Winn, *Introduction: Symposium on Globalization of Secured Lending*, 34 INT'L LAW. 1089, 1090 (Winter 2000) (Article 9 "succeeded in simplifying the process of secured lending and encouraged a huge expansion in secured lending to U.S. businesses in the decades following the enactment of Article 9"); Wilson, *supra* note 16, at 47 ("secured lending has become a vital component of the U.S. economy"); Anthony Saunders et al., *The Economic Implications of International Secured Transactions Law Reform: A Case Study*, 20 U. PA. J. INT'L ECON. L. 309 (1999) (proclaiming advantages of UNIDROIT Convention on Mobile Equipment and Its Aircraft Protocol). Interestingly, the law and economics movement started out "puzzled" by the institution of secured credit. *See* Alan Schwartz, *The Continuing Puzzle of Secured Debt*, 37 VAND. L. REV. 1051 (1984). More recently, the law and economics movement seems to have become convinced that personal property security is beneficial because the power which it gives to the creditor over the assets of the debtor tends to prevent the debtor from engaging in risky ventures or otherwise misbehaving. *See infra* Part I.C.9. Some prominent U.S. scholars in the movement still doubt that secured creditors should be entitled to absolute priority in bankruptcy. *See* Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996).

[19] Heywood W. Flesig & Nuria de la Peña, *Argentina: How Problems in the Framework for*

by "reform" of these domestic laws to provide for easy security interests, they argue, will these countries be able to compete with U.S. and Canadian firms who can borrow at lower rates.

The campaign by economists to sell Article 9 principles around the world everywhere meets resistance by legal scholars cognizant of the implications which security devices carry. Most notably, a project in the 1990s within Argentina's Banco Central to promote the Article 9 principles, was rejected by Argentine jurists.[20] The extensive report of the Asian Development Bank cautions:

> There is no single model of a secured transactions legal regime and there are wide variances among developed countries in Europe and North America.
>
> Consequently, this is not an area where one can refer glibly to common law rules, general standards or global "best international practices." Instead reform of secured transactions regimes in developing countries needs to be carefully tailored to the legal tradition of each country and should be designed to achieve the particular economic and social policy choices that policy makers in each country wish to pursue.[21]

It is not the purpose of this study to argue for or against changes in the secured credit or insolvency law of Argentina or the U.S. The perpetual clash of interests noted by Madison and the contemporary pressures of the global economy are likely to assure that these areas of law will be subject to

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Secured Transactions Limit Access to Credit, Center for the Economic Analysis of Law (1996); Wilson, *supra* note 16, at 60; Horacio E. Gutierrez-Machado, *The Personal Property Secured Financing System of Venezuela: A Comparative Study and the Case for Harmonization*, 30 U. MIAMI INTER-AM. L. REV. 343 (1999). According to the ADB Study:

> Private creditors in all countries—common law and civil law, industrial and transitional, north and south—worry about getting their loans repaid. Everywhere, when the debtor can offer them collateral for a loan, private creditors offer larger loans, at lower interest rates, payable over longer periods of time. Compared to a debtor who cannot offer good collateral, one with such collateral can anticipate receiving six to eight times more credit, taking two to ten times longer for repayment, and paying interest rates 30 percent to 50 percent lower. Collateral is important.

ABD Study, at xiii.

[20] *See* CARLOS GILBERTO VILLEGAS, LAS GARANTÍAS DEL CRÉDITO, Vol. II 405-411 (2d ed. 1998) [hereinafter GILBERTO VILLEGAS].

[21] ADB Study, at v.

continuing scrutiny in both countries. Instead, we first urge that the law governing the creation and enforcement of security devices and the way in which insolvency laws impact these devices be considered together as part of one system of financing.[22] The power which secured credit devices give to the creditor may be either checked or enhanced once the debtor files an insolvency proceeding. Second, by comparing how secured credit and insolvency law interact in Argentina and the U.S., we believe that it is possible to gain insight as to the core values and attitudes embodied in the present legal systems and a helpful viewpoint for evaluating proposed legal changes in either country. Comparison may even tend to free us from the ideological commitments which still seem to dominate discussion of the rights of debtors and creditors.[23]

I. AN OVERVIEW OF SECURED CREDIT IN ARGENTINA AND THE UNITED STATES

A. Different Security Devices: Lack of Common Vocabulary

Argentina and U.S lawyers lack a common vocabulary for discussion of secured credit. Argentine law does not speak of "security interests" or "secured credit." Instead, it distinguishes between two types of guaranty (*garantía*): personal and real. As in the U.S., a personal guaranty is an obligation given by a third person to pay the debt of another. In the Argentine system, such a guaranty is classified as personal because it does not create a real right above any identified assets of the principal debtor. It gives the creditor a second person to look to for payment if the principal debtor fails to pay as promised.

In contrast, real guaranties create a real right above assets owned by the debtor. Argentine lawyers think of real guaranties as specific contractual forms grounded in particular statutory provisions. One of the most important

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[22] Many of the advocates of Article 9 principles seem to gloss over the importance of correlating personal property security law with insolvency systems. The ADB does not. *See* THE NEED FOR AN INTEGRATED APPROACH TO SECURED TRANSACTIONS AND INSOLVENCY LAW REFORMS, 1 LAW AND POLICY REFORM AT THE ASIAN DEVELOPMENT BANK (Apr. 2000). Note that Mexico's changes in 2000 to its personal property security laws were accompanied by changes in its insolvency laws. *See* Del Duca & Etcharren, *supra* note 13, at 250.

[23] *See* Rodolfo Sacco, *Legal Formants: A Dynamic Approach to Comparative Law*, 39 AM. J. COMP. LAW 1, 5 (1991) (objective of comparative study is insight). Kai Schadbach, *The Benefits of Comparative Law: A Continental European View*, 16 B.U. INT'L L.J. 331, 335-67 (1998) (comparing legal institutions leads to new insights about one's own legal system).

forms of real guaranty is the *hipoteca*. Article 3108 of Civil Code describes the *hipoteca* as "the real right constituted in security of a credit in money, above the immovable assets, which continue in the power of the debtor."[24] Specific statutory provisions allow *hipotecas* to be used to cover planes and ships of more than ten tons as well as immovable assets.[25] The *hipoteca* must be embodied in a notarized writing. In order for it to be effective against third parties, the *hipoteca* covering immovables must be inscribed on the Register of Immovable Property.[26]

Several types of pledges (*prendas*) also constitute real guaranties in Argentina. These contracts create real rights over movable assets. The Civil Code recognizes a classical *prenda* which requires a transfer of possession of the pledged asset to the creditor.[27] Similarly, Articles 580 to 588 of the Commercial Code recognize the commercial pledge. Article 580 provides: "the contract of commercial pledge is that through which the debtor, or a third person in his name, delivers to the creditor a movable thing, in security and guaranty of a commercial operation." Article 581 adds: "The lack of a written document in the constitution of the pledge ought not to be objected to by the debtor when he has delivered the thing, but by his creditors." In addition, contemporary decrees provide for a registered pledge (*prenda con registro*) which allows the debtor to remain in possession of the goods. According to the decree law, the registered pledge must be embodied in a written contract and inscribed on a registry.[28]

Discussion of secured credit in the United States is dominated by the generic "security interest" of Article 9 of the U.C.C. This "security interest" is conceptualized as any interest in the personal property of the debtor which operates to secure an obligation owing to a creditor. Any agreement,

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[24] In the civilian tradition, Argentine law distinguishes between *bienes muebles* and *bienes inmuebles*. An instinctive common law reaction is to equate these categories with the common law distinction between goods and real estate. The match between these fundamental distinctions is not perfect, however. Under Argentine law, each floor or department of a building may be mortgaged separately. The mortgage may extend to rents derived from the immoveable property.

[25] Ley de Navigacion 20.094, Arts 499-508, Código Aernáutico, Capítulo VI, Arts 52-57. *See* GILBERTO VILLEGAS, *supra* note 20, Vol. I, Capítulo XII ¶ 9.

[26] GILBERTO VILLEGAS, *supra* note 20, Vol. I, Capíitulo XII, ¶ 4.4.

[27] Civil Code Arts. 3204-3217; *see* discussion in Part I.C.*1*.

[28] Decreto Ley 15.348/46. *See* ROBERTO A. MUGUILLO, PRENDA CON REGISTRO (3d Editorial Astrea 2001) and the discussion in Part I.C.*3*.

regardless of its label or form, which creates such an interest qualifies as a "security agreement" and is governed by Article 9 of the U.C.C.[29]

The assets covered by any security agreement are called "collateral." The debtor's consent must be manifested in an authenticated record describing the collateral.[30] Through these means, any person may take a security interest in almost any type of personal property, incident to any type of transaction. Public notice of the security interest is typically given by filling an abbreviated notice called a "financing statement," not the security agreement itself.[31]

But Article 9 does not extend to real estate financing. Real property must be covered by a mortgage or similar formal real estate security document. The law of real estate financing is not embodied in the U.C.C. and varies somewhat from state to state.[32] The mortgage document must itself be recorded. No doubt there are many technical differences between the Argentine *hipoteca* and the U.S. real estate mortgage, but transactional lawyers structuring real estate transactions would recognize the similarity of these formal security devices. In litigation to enforce the mortgage, the mortgage holder will be treated as having an interest in the real property which does not exceed the lesser of: 1) the value of the real property, or 2) the amount of the debt secured by the mortgage.[33] In insolvency proceedings the mortgage holder will be classified as a " secured creditor" to the extent of this interest.[34] Thus, in operation, U.S. law deals with mortgage much in the same way it treats an Article 9 security interest. In both cases, the creditor is deemed to have an interest in the property owned by the debtor measured by the amount of the secured debt.

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[29] U.C.C. §§ 9-102(a)(73); 9-109 (2001).

[30] U.C.C. § 9-203 (2001).

[31] U.C.C. §§ 9-310(a); 9-502; 9-516(b)(5) (2001).

[32] *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW (3d ed. 1993) [hereinafter NELSON & WHITMAN]. The document used may actually be called "a deed of trust" or a "security deed" in some states. Note, however, that the most recent ALI Restatement, reflecting the functional conceptualization of Article 9, ignores distinctions of label or form. A mortgage, it declares, "is a conveyance or retention of an interest in real property as security for performance of an obligation." RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 1.1 (1997).

[33] Thus, the recent Restatement declares: "A mortgage creates only a security interest in the real estate. . . ." RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 4.1 (1997).

[34] *See* 11 U.S.C. §§ 101(37) and 506(a).

B. Priority to Debtor's Assets in Insolvency as the Defining Characteristic of Secured Credit

Despite all the differences in vocabulary, the Argentine *hipoteca* and *prenda* and the U.S. real estate mortgage and security agreement serve the common function of providing a creditor with a priority claim to assets owned by the debtor in the event that insolvency proceedings are initiated. In both systems these security devices give the creditor a limited interest in assets to which the debtor holds the general ownership interest. In both systems, the security devices are "accessory" to the debt obligation.[35] The debt measures the extent of the creditor's interest. If the debt is paid in full, the security device is extinguished. But if the debtor defaults in payment, the creditor has a priority interest in the covered assets above the claims of common creditors.[36] It is this priority characteristic which leads us to categorize creditors with these devices as "secured creditors," and to speak of the property covered by the arrangements as "collateral assets."

The general principle of Argentine law is that all creditors of the common debtor have an equal claim to the debtor's assets. This core principle is metaphorically expressed in Article 2312 of the Argentine Civil Code which declares that the entirety of the assets of a person constitute a *patrimonio* which is "the common pledge of the creditors."[37] This core principle appears to have been inspired by Article 2093 of the French Civil Code declaring "the property of a debtor is a pledge in common for his creditors."[38] As exceptions to the general principle of the common *patrimonio*, Argentina statutorily recognizes privileges giving priority to specified creditors. The definition of a privilege is the "right given by the law to a creditor in order to be paid in preference to others."[39] Article 241 of Ley 25.522 describes special privilege applicable in insolvency proceedings. The listing of Article 241 includes the credits guaranteed by *hipoteca* or *prenda*.

Creditors whose debts are guaranteed by *hipoteca* or *prenda* are by no means the only priority creditors recognized by Argentine law.[40] In the context

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[35] As to Argentina, see PATRICIA FERRER, DERECHO DEL ACREEDOR HIP TE CAMO EN EL PROCESSO CONCURSAL § 10 (Editorial Astrea 2000) and GILBERTO VILLEGAS, *supra* note 20, Vol. I, at 80-81. As to the U.S. see Judge Posmer's opinion in Unisys Financial Corp. v. RTC, 979 F.2d 609, 611 (7th Cir. 1992) ("A lien is parasitic on a claim. If the claim disappears—poof! the lien is gone.").

[36] U.C.C. §§ 9.201 and 9-317 (2001); Ley 24.522, art. 241.

[37] CÔD. CIV. art. 2312 (Arg.).

[38] C. CIV. art. 2093 (Fr.).

[39] CÔD. CIV. art. 3875 (Arg.).

[40] *See infra* notes 41-45.

of the issuance of corporate debt securities, debentures or negotiable obligations may be issued with common, special or floating guaranties.[41] The common guaranty does not provide the creditors with rights over the assets of the debtor but may allow the bankruptcy judge to suspend the management of the debtor. The specific or floating guaranties do produce priority claims even though the formalities otherwise required for *hipotecas* or *prendas* are not observed. Debentures or obligations with specific guaranties cover identified assets susceptible to *hipotecas* or *prendas*. Similar credit instruments with a floating guaranty cover all rights, movable or immovable, present or future of the issuer. Under Article 152 of Ley 24.522 a debenture or obligation with a specific guaranty gives the creditors the rights in bankruptcy proceedings of a creditor with a *hipoteca* or *prenda*. The fiduciary representative of bondholders with a floating guaranty is a co-liquidator of the debtor along with the bankruptcy trustee.[42] Issuers of these credit instruments more frequently use negotiable obligations rather than debentures. Since both of these specialized instruments involve the issuance of debt securities, they do not typically provide a means of financing for small and medium sized enterprises that are not able to access securities markets.

In contrast is the privilege recognized by Article 246 of Ley 24.522 for accepted invoices (*facturas de crédito aceptadas*) drawn on a debtor enterprise. Under this provision, suppliers of goods or services whose invoices have been accepted by the debtor are granted a general privilege of up to $20,000 even though they do not have a *prenda* or *hipoteca*.[43] This provision is designed to aid small and medium sized enterprises in financing their purchases of inventory, equipment and services.[44] Note, however, that each accepted invoice is tied to a particular credit transaction and will specify the exact sums owed to the supplier. Thus, this priority device will have much the same particularization which is required for the registered pledge.[45]

Priority under U.S. law is established by classifying the creditor's claim as secured rather than unsecured.[46] Section 506 of the Bankruptcy Code states that a secured claim exists "to the extent of the value of such creditor's interest in the estate's interest in such property." It is the conceptualization of a creditor's interest under Article 9 and the law of real estate finance as a type of property right in the asset of the debtor that entitles the creditor to priority.

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[41] Ley 24.522, art. 152. *See* GILBERTO VILLEGAS, *supra* note 20, Vol. II, 340-47, 350-51.
[42] *Id.* ¶ 2.
[43] *Id.* art. 246.
[44] *Id.*
[45] *See* discussion of the registered pledge in Part I.*C.3 infra*.
[46] 11 U.S.C. § 506.

Interestingly enough, nothing in the Bankruptcy Code specifically says that secured creditors get paid first. The priorities described for distribution of assets under section 507 of the Bankruptcy Code are, however, universally understood as coming into effect only after secured creditors have been paid.[47] The priority status of security interests is also recognized in a rather understated way by Section 361 of the Bankruptcy Code acknowledging that the secured creditor is entitled to adequate protection of its interest so long as the collateral remains in the possession of the debtor.

Treating a priority claim to the debtor's assets as the defining characteristic of secured credit means that a credit supported by a personal guaranty standing alone does not qualify as a form of such financing. That is not to say that the personal guaranty is not a critically important financing device in both countries. In fact, a personal guaranty from the principals of a small or medium size enterprise is standard practice in the U.S. even when the financing is also secured by all of the personal property assets.[48] Other very important financing devices fall outside the field of secured credit as we have defined it for purposes of this paper. Devices which involve an absolute sale of the debtor's assets to the financer or the third party including the traditional factoring of accounts and the contemporary securitization of promissory notes and other receivables also assure payment despite the insolvency of the seller of the assets. These procedures completely remove the assets from the debtor's bankruptcy estate rather than creating a priority right to be paid from those assets in the event of the debtor's insolvency. Similarly, leasing of personal or real property by the financer to the debtor does not give the creditor an interest in property owned by the debtor. The lease leaves the lessor-financer with ownership of the asset and gives the lessee-debtor a right to use the property for a term in return for the rental payments. In this paper

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[47] One leading bankruptcy treatise states:

> Secured claims are not listed in section 507 which establishes the hierarchy of claims or in 726 that describes distribution from the estate. Nevertheless, secured claims are always given top priority as to the assets subject to the security. Perhaps this was thought so obvious that it need not be stated in the Code, but a security interest that cannot be set aside (whether a mortgage, an Article 9 security interest, or some other form of lien) continues after the discharge as a claim on the assets subject to the security. The bankruptcy has no effect because bankruptcy honors the property principle of derivative title, and the lienor's interest in the debtor's property is excluded from the bankruptcy estate.

3 DAVID G. EPSTEIN ET AL., BANKRUPTCY §§ 7-10 p. 461 (est. 1993).

[48] *See* LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 297-99 (3d ed. 2000) (guarantee part of prototypical secured transaction).

we draw important theoretical and practical contrasts between credit arrangements which involve ownership of assets by the financer and those which involve ownership by the debtor subject to an interest or right in creditor. Only the latter arrangements constitute secured credit devices for purposes of our present analysis.

C. Patterns of Secured Credit

1. Importance of Possessory Security

Both Argentine and U.S. law recognize the classic pledge (*prenda*).[49] The essence of this security device is that the assets must be removed from the possession of the debtor and placed in the control of the creditor or its agent. Argentine law captures the core of this ancient technique most accurately by stating that there must be a *desplazamiento*, i.e., a displacement.[50] Psychologically, the pledge with displacement remains the ideal security device for personal property for Argentine lawyers and financers alike. In contrast, the pledge effected by displacement of possession is no longer the ideal model in U.S. thinking.

Still, the classic pledge supports commercially vital financing in both systems. Rights to payment embodied in promissory notes or drafts are commonly pledged as are securities certificates. Moreover, where goods can be stored, they can be covered by documents (warehouse receipts in the U.S., warrants in Argentina) and the documents can then be transferred to a creditor by way of pledge.[51]

It is important to recognize how much the displacement of possession means both to the creditor and to the legal status of this classic device. Possession of the collateral by the creditor prevents the debtor from hiding, selling, or otherwise harming the crucial assets which the creditor looks to for assured payment. Moreover, both Argentine and U.S. law give the creditor in

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[49] COD CIV. arts. 3211, 3217. U.C.C. § 9-313 (2001). The U.C.C. does not use the term "pledge." Instead, it states that a security interest is negotiable documents, goods, instruments, money or tangible chattel paper may be perfected by the creditor taking possession of the collateral.

[50] 1 GILBERTO VILLEGAS, *supra* note 20, Capítulo 1X, ¶ 6.

[51] The Argentine system for warrants was established by Ley No. 9643 (1914). When merchandise or products are stored in an authorized warehouse, the warehouse issues two documents: a certificate of deposit and a warrant. The certificate of deposit can be used to transfer ownership of the stored goods; the warrant to effect a pledge. *See* 1 GILBERTO VILLEGAS, *supra* note 20, Capítulo X. U.C.C. § 9-313(a) (2001) permits security interests in negotiable documents of title to be perfected by taking possession.

possession the right to sell the pledged assets privately without any judicial proceeding when the debtor defaults.[52] Swift and economical enforcement of the pledged assets through this right of direct realization leads Gilberto Villegas to describe the classic *prenda* as a "liquid guaranty."[53] Clearly, Argentine bankers and lawyers are comfortable with this technique.

Given the displacement, there is no doubt that the debtor understands the nature of the transaction and is, at least in some sense, consenting to it. The displacement provides evidence that the interest has been created. The displacement of possession also deprives the debtor of the use and enjoyment of his property. It seems much less objectionable to give a chosen creditor privileged status when doing so cannot be a shield to allow the debtor to enjoy the asset while denying any claim to it to non-preferred creditors. The comfort-level with the classic pledge in the Argentine system is manifested in the minimal additional formalities required for it. The Civil Code demands only that the pledge contract be in writing containing the amount of the credit and a description of the pledged assets.[54] Article 581 of the Commercial Code provides that the lack of a writing to evidence a commercial pledge is not a basis for objection by the debtor who has delivered the pledged assets, only for third-party creditors.

2. *Argentine Hipoteca and U.S. Mortgages: Devices Which Share Formality*

As the displacement required for a classic pledge strikingly shows, formalities are not necessarily evil. Indeed, they are an essential feature of all legal systems.[55] The policy question is always whether the required formalities are the appropriate ones for the particular legal device in question. A

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[52] CÓD CIV. art. 3234, CÓD COM. art. 585, U.C.C. § 9-610 (2001).

[53] *See* GILBERTO VILLEGAS, *supra* note 20, ch. VI, ¶ 4.2.

[54] *See* CÓD CIV § 3217. A writing or record is not a legal precondition to the effectiveness of a possessory security interest under the U.C.C. § 9-203 (2001). Technically, the oral agreement of the debtor plus a transfer of possession would be sufficient. However, it is the near universal commercial practice to have a written pledge agreement.

[55] The definitive treatment of formalities in the U.S. literature is Lon I. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799 (1941). Professor Fuller argued that the formality of consideration in U.S. contract law serves evidentiary, cautionary and channeling functions. The "channeling" function refers to the capacity of the parties to selecting a required formality to "channel" their transaction into a form recognized by the law as enforceable. The formality of displacement serves similar needs. At the same time that formalities may serve these objectives, they may impact adversely on the secured creditor since failure to satisfy a formality may cause invalidation of an interest to which the debtor actually agreed. Formalities serve "legal order" objectives but tend to frustrate the creditor's interest in facilitating the transaction.

comparison of the Argentine *hipoteca* and U.S. real estate mortgage reveals devices which in commercial practice share a considerable degree of formality. In both cases these devices involved notarized writings which are themselves recorded.

Argentine authors describe their *hipoteca* as having the qualities of *excepcionalidad* and *especialidad*.[56] The *hipoteca* is an exception to the general principle that creditors have an equal claim to all assets of the debtor. Under the attribute of *especialidad*, the *hipoteca* must be specific both as to the assets covered and the debt obligation. As to the property description, Ferrer writes:

> The mortgage ought only to be constituted above immovable things, specifically and expressly determined. The asset ought to be found perfectly individualized at the moment of the creation of the encumbrance.[57]

In this respect, the Argentine *hipoteca* resembles its U.S. counterpart since exact "legal" descriptions of the real estate are commonly used in the mortgage.[58]

It does not appear, however, that the required specificity is the same when it comes to describing the mortgage debt. Argentine authorities agree that the *hipoteca* may not cover all of the debt owed from time to time by the debtor to the creditor. At the least the mortgage must contain an estimate of its value so that third parties may calculate the extent of the creditors "exceptional" priority.[59] In the U.S. the mortgage itself is not required to identify the amount of the debt with any particularity. The document may contain "future advances" provisions allowing new loans to be swept in with the secured obligation.[60] As we will later see in regard to personal property security

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[56] *See* PATRICIA FERRER, DERECHO DEL ACREEDOR HIPOTECANO EN EL PROCESSO CONCURSAL §§ 11, 14 (Editorial Astrea 2000).

[57] *Id.* § 14.

[58] Less formal descriptions may be effective between the debtor and creditor. But in order to be effective against third parties, the recorded U.S. documents must at least allow third parties searching the record to identify the real property. *See* RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.5 and comment thereto (1996).

[59] *See* FERRER *supra* note 56, § 141; *see also* GILBERTO VILLEGAS, *supra* note 20, Capítulo XII ¶ 5.2.

[60] *See* 1 GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 2.4 (1993) (U.S. mortgage itself need not specify amount of debt); RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 2.1 (1996) (describing permitted "future advances").

interests, the U.S. system is much more receptive to informal proof of the amount of the debt.[61]

For several reasons the formality of the *hipoteca* and mortgage do not prevent them from being effective security devices. Each tract of land is unique, demanding some particularity in description to identify it. Real estate financing is often very long term financing for considerable sums so that increased costs in taking and recording instruments are not prohibitive. Finally, land, unlike the typical personal property assets, does not depreciate. These economic factors, plus the traditional prestige associated with real estate ownership, allow the *hipoteca* and mortgage to function effectively despite their formality.[62]

Current market practices as to both the Argentine *hipoteca* and the U.S. real estate mortgage underscore the powerful collection leverage which having a security interest in a debtor's home gives to the creditor. Both countries have very active first and second residential mortgage markets. In the U.S. some now fear that the leverage of the residential real estate mortgage tempt some financers to extend credit even when they know that the borrower will have great difficulty in making the payments. The boundary line between generous credit and "predatory" lending can be difficult to draw.[63]

3. Formality of Argentina's Registered Pledge

The problem with the classic pledge is not its legal status, but the limitation on the range of transactions where it is commercially feasible. Usually, commercial and consumer assets must be left in the hands of the debtor. It is in this context that the personal property security law and practice of the two nations converge. The Argentine system is grounded in formalities designed to prevent fraud, mistake and overreaching. The formality of the Argentine system is initially revealed in the documentation required to create non-possessory interests. Its legislation for registered pledges distinguishes between a fixed and floating pledge.[64] The fixed registered pledge is widely

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[61] *See infra* Part I.C.5.

[62] The Argentine financer's preference for the real estate mortgage is confirmed by Flesig & de la Peña, *supra* note 19, at 2.

[63] Recent years in the U.S. have seen a large increase in mortgage lending to poorer credit risks. Foreclosure rates have also risen sharply in this "subprime" lending group. Consumer advocates have accused the mortgage lenders of predatory practices including lending with the anticipation of having later to foreclose. *See* Hilary B. Miller, *Payday Loans and Predatory Lending*, 1242 PLI/CORP 113 (2001).

[64] Decreto Ley 15.348/46 and Decreto 875 185. Decreto Ley 15.348/46 is identified herein as the "Registered Pledge Law." For the history of this legislation *see* ROBERTO A. MUGUILLO,

used by financers. In particular, the acquisition of all types of motor vehicles occurs through use of the fixed registered pledge. The device is also employed in the financing of industrial and agricultural machinery. In addition, Article 14 of the Decree Law 15.348/46 authorizes a floating registered pledge over the merchandise and materials of commercial and industrial debtors.[65] Financers have much less confidence in the floating registered pledge.[66] The emphasis in the civilian tradition is on security as a "real right" which follows the assets even after they are transferred by the debtor. But it is clear that inventory assets at least may be sold free of the floating registered pledge so it is difficult to square a floating pledge over inventory with the idea of real security. As will be explored later, concerns as to whether floating registered pledges can be effectively enforced seem to explain why they are not used as widely as the fixed pledge.[67] In this section we examine the formalities for the fixed registered pledge, the principal non-possessory security device for personal property under Argentine law.

The fixed pledge requires specific identification of the assets pledged and the tying of each pledge transaction to a specific debt. The registered pledge law stresses the need for the pledge contract to provide the most precise identification of the assets as well as the amount of the credit, the rate of interest and the time, place and manner of the payments. It details 16 additional elements of information to be stated in the contract.[68] This elaborate

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PRENDA CON REGISTRO §§ 10-14 (Editorial Astrea 2001) [hereinafter MUGUILLO].

[65] *See* MUGUILLO, *supra* note 64, at 112-13.

[66] Flesig and de La Peña note that scholars even question the legitimacy of a floating security interest. *See* Flesig & de la Peña, *supra* note 19, at 35.

[67] *See* Part I.C.7 of this paper.

[68] Article 11 of the Registered Pledge Law reads:

> In the contract the following essential specifications should be shown in the respective record:
>
> a) First name, family name, nationality, age, civil status, domicile and profession of the creditor.
>
> b) First name, family name, nationality, age, civil status, domicile and profession of the creditor.
>
> c) Amount of the credit and rate of interest, time, place and manner of payments.
>
> d) descriptions tending to individualize the assets pledge. If the pledge covers livestock these are to be individualized through indications of their class, number, age, sex, grade of breeding, mark, signal, certificate or guide with mention of the number of record, date of the office in which the mark or signal is registered and which has issued the guide or certificate. If it deals with other assets, the individualization will be the most specific possible with respect to quantity, quality, weight, number, analysis, factory mark, patent, controls to which they will be

array of formalities is designed to substitute for the displacement of possession which occurs under the classic pledge.

This detailed contract of pledge must be registered in order for the interest to be effective against third parties.[69] The registration is with one of the Registros Nacionales de la Propiedad del Automotor y Creditos Prenarios.[70] The registry then provides a certificate of pledge which evidences in a public instrument the privilege established by the private contract.[71] It is the certificate of pledge which provides specific evidence of the fact and extent of the creditor's privilege.

4. *The Much Less-Formal U.S. Security Interest*

In contrast, the formalities for attachment of a security interest under Article 9 of the U.C.C. are strikingly minimal. The debtor must agree to the creation of a security interest in the debtor's assets.[72] Normally, this agreement must be embodied in a paper or electronic record describing the collateral which is authenticated by the debtor. Collateral may be described by general categories (*e.g.* "all inventory," "all accounts").[73] The security agreement may cover antecedent debt or advances made by the creditor after execution of the agreement along with the loan or other value extended when the agreement is authenticated.[74] Typically, the secured obligation will be defined in the agreement to embrace all debts then or thereafter owed by the debtor to the secured party.[75] Such "dragnet" or "all obligations" clauses are generally enforced at least with respect to commercial financing.[76] A security

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> subject and whichever other particularities that contribute to the individualization of the assets.

Following French law the statute also states that the prenda may describe a "fundo de commerce" including installations as well as the intellectual property of the firm, but not its merchandise.

[69] *See* Registered Pledge Law Art. 4. *See* Muguillo pp. 53-58.

[70] *See* GILBERTO VILLEGAS, *supra* note 20, at 297.

[71] *See* Registered Pledge Law, *supra* note 64, art. 18.

[72] *See* U.C.C. § 9-203 (2001).

[73] *See* U.C.C. § 9-108 (2001).

[74] *See* U.C.C. § 9-204(c) (2001).

[75] *See* Julian B. McDonnell, *The Priority of Future Advances and "Non-Advance" Obligations*, *in* SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 7C.02[5] (Bender 2001).

[76] Historically, some courts have limited the reach of "dragnet" or "all obligations" clauses by applying a relatedness test *i.e.* debt claimed to be secured must be of the same type as the primary obligation and so related to it that the debtor's consent may be inferred. In the recent case law under pre-Revision Article 9 courts have generally found the relatedness test to be

agreement may secure existing, antecedent debts which were either secured or unsecured at the time of their creation.[77] The security agreement may also cover assets acquired by the debtor after the execution of the agreement ("after-acquired property").[78] If the debtor sells collateral assets, the security interest automatically attaches to the identifiable "proceeds" received by the debtor even though the proceeds are not themselves described in the security agreement.[79] For example, sums received from the sale of inventory or collection of accounts would constitute "proceeds" of these assets even if deposited in the debtor's bank account.

Under Article 9 the security agreement normally operates to make the security interest effective between the debtor and the secured creditor. But for priority over other creditors and the debtor's trustee in bankruptcy, the secured creditor must take the additional step of "perfecting" its interest. For most physical assets perfection can be accomplished by transferring possession to the creditor. But such a displacement of possession is no longer the standard way of perfecting. In most cases, perfection is accomplished by filing an abbreviated notice called a financing statement, which simply identifies the parties and provides an indication of the collateral covered by the arrangement.[80] Under the "notice filing system" it is not necessary or customary to record the actual security agreement. A searcher locating the filed financing statement must then obtain a copy of the security agreement from the debtor or secured party to determine exactly what interest has been created. The financing statement need not state the amount of the debt. It may be filed (on authorization of the debtor) in advance of the parties coming to any agreement or any financing being extended. The financing statement is not tied to any particular debt obligation or security agreement but operates for a five year period to perfect whatever security interests have been or may be created.

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satisfied so long as all of the obligations arise from the extension of business financing to a commercial enterprise. But relatedness is sometimes used to restrict dragnet language in consumer cases. For example, dragnet language in a consumer secured agreement signed to finance the acquisition of a car may not suffice to secure debt under a credit card issued by the same financer to the same consumer debtor. *See, e.g.*, *In re* Robinson, 217 B.R. 527, 35 U.C.C. Rep. Serv. 2d 1339 (Bankr. E.D. Tex. 1998). Comment 5 to Revised U.C.C. § 9-204 expresses general disapproval of the relatedness test. It remains to be seen whether courts will follow this comment in consumer cases.

[77] *See* U.C.C. § 1-201(44) (2001).

[78] *See* U.C.C. § 9-204(a) (2001).

[79] U.C.C. § 9-315(a)(2) (2001).

[80] U.C.C. §§ 9-502; 9-516(5) (2001).

The Article 9 system represents a long evolution away from the norm of the classic pledge. In this system it is now considered totally normal that the debtor will remain in control of the collateral—even collateral in the form of more liquid assets such as inventory, accounts, collections and deposit accounts.[81] Article 9 rules allowing very general description of the property, permitting the agreement to cover after-acquired interests and to secure all indebtedness existing between the debtor and the creditor, and allowing the creditor's interest to extend automatically to proceeds of the original collateral, collectively operate to facilitate the creation of a "floating lien" over all of the assets of the business debtor or broad categories of assets such as all inventory, all accounts or all livestock owned by the debtor. "Floating lien" financing is a standard feature of financing for small and medium size enterprises in the U.S. As much as eighty percent of small business financing may be extended on a secured basis.[82]

The filing system also operates to support this pattern of financing. The normal rule among secured creditors gives first priority to the first secured creditor to file or perfect (FTFOP).[83] A secured party who is first-filed as to particular assets (e.g. the accounts of the debtor) will routinely be assured of having the first priority interest in those assets entitling it to a satisfaction of its debt before the claims of other creditors, secured or unsecured. In theory, assurances of being first in law also gives that secured party the psychological assurance which will cause it to be generous in its extension of credit.[84]

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[81] *See* U.C.C. § 9-205 repealing the famous decision in Benedict v. Ratner, 268 U.S. 353 (1925), which held that a creditor must collect collections from accounts in order for an assignment of accounts to be valid.

[82] *See* John D. Leeth & Jonathan A. Scott, *The Incidence of Secured Debt: Evidence From the Small Business Community*, 24 J. FIN. & QUANTITATIVE ANALYSES, 379 (1989).

[83] U.C.C. § 9-322 (2001). There are exceptions from the FTFOP rule for purchase of money interests in goods. Generally speaking, an interest is a purchase money interest to the extent that it is retained by the seller of goods to secure payment of the price of the goods or taken by a lender whose advances are used by the debtor to pay the price of the goods. U.C.C. § 9-103 (2001). In designated circumstances, a purchase money financer of inventory, equipment or cattle may defeat a first-filed floating lienor.

[84] This argument is referred to as the "claim staking" function. The creditor is visualized as staking its claim to the debtor just as a mineral prospector would stake its claim to minerals in a designated track of land. With its priority assured, maximum mining or financing would then be encouraged according to this theory. *See* Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901 (1986).

5. *Differing Receptivity to Informal Proof of Priority*

The generality allowed in the security agreement and financing statement both as to the collateral and debt covered means that the identification of the specific assets involved and the dollar amount of the debt will often need to be established by extrinsic evidence in the event of bankruptcy or litigation in other fora. Invoices, bank statements, other company records as well as testimony of officials of the debtor or financer may be relied upon to flesh out details of the debtor collateral coverage. This reliance occurs after the debtor has defaulted and all of its creditors are fighting to establish their priority positions.

The Article 9 policy of informal documentation of the security interest necessarily carries with it receptivity to informal proof of the extent of the creditor's priority after the debtor defaults. We see in this receptivity to informal proof of the amount of the debt and exact collateral items a critical difference between the common law system of the U.S. and Argentine civilian system. In Argentina, the assets covered by the registered pledge and the amount of the secured debt are to be proved by a public act, not by informal evidence.

6. *Differing Policy Priorities*

Even more fundamentally, the differences in documentation required for the registered pledge and the security interest expose basic policy choices embodied in the respective legal systems. As noted earlier, formalities may serve important "legal order" objectives such as minimizing evidentiary disputes and enhancing the quality of the debtor's understanding of the transaction.[85] But at the same time, formalities make it more difficult for the creditor to establish its priority claim. Each additional formality is, from the creditor's viewpoint, a potential trap. Failure to satisfy the formality may cause invalidation of its interest.

Critics of the U.C.C. may argue that Article 9 makes life easy for creditors because major financers dominate the U.C.C. drafting process.[86] A developing literature does question the role of big banks, securities firms and major corporations in the U.C.C. drafting process.[87] Supporters will reply that making it easy to create and perfect security interests reflects the enterprise

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[85] *See supra* note 55.

[86] *See* Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783, 1790 (1994).

[87] *See* Symposia, 54 SMU L. REV. 469 (2001) and 52 HASTINGS L.J. 603 (2001).

preference of U.S. law. Article 9 in their view is designed to give firms the maximum chance to flourish by maximizing their access to credit.[88] The enterprise preference gives priority to promoting the commercial venture even at the risk of permitting creditor misconduct. The demands of finance capitalism erode traditional legal precautions.

We do not find it necessary to choose between these rival explanations of the Article 9 system. We suspect instead that the Article 9 system has evolved *both* because of the political clout of the financers and because of the almost instinctive U.S. proclivity to foster private commercial enterprise.

In contrast, the "legal order" precautions still have the priority position in Argentine law. The Argentine imperative is to prevent fraud, mistake or overreaching as to the "exceptional" priority of the secured creditor. Argentina's current documentation requirements for registered pledges are heavily influenced by the perception that earlier legislation allowing registered pledges for agricultural machinery, crops and livestock was abused. One commentator describes "excesses" occurring under the agricultural pledge law as "the simulation of pledges without displacement on the part of dishonest debtors and false creditors to the prejudice of legitimate creditors" as well as the utilization of such pledges to support usurious transactions.[89] In neither the academic nor practitioner-oriented literature in the U.S. will one find any concern whatsoever about false claims of security interests. The U.S. legal community has either managed to convince itself that fraudulent assertion of secured credits is not a significant possibility or that the judicial system will be able to identify and invalidate false claims if they are made. The U.S. policy is to trust the judicial process. The civilian tradition of Argentina expresses less confidence in the judicial process. Thus, it demands that the crucial facts be established in a public document at the outset of the credit relationship. Argentine law gives priority to preventing commercial abuses other than maximizing the enterprises chance of success.

To repeat: describing the Argentine system as more formal than the U.S. system does not in any way establish that the Argentine system is bad and the U.S. good. Formality is a normal feature of the legal order as indeed the Argentine *hipoteca* and U.S. mortgage reflect. The critical issue in each case is whether the appropriate formalities are in place. That issue involves the weighing of competing values. Economic objectives tend in this area of the law to clash with traditional legal concerns. The policy judgment also

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[88] *See supra* note 18.

[89] JULIO ALBERTO KELLY, DERECHOS DE GARANTIA SOBRE BIEN MUEBLES; PRENDO CON REGISTRO Y LEASING 37 (1989).

involves determination of whether the particular formalities in place are actually efficacious to achieve the desired mix of objectives.

7. *Differences in Enforcement*

With the registered pledge, the collateral assets remain in the control of the debtor, and the creditor does not have the immediate right of sale on default that exists with the classic pledge. Article 28 of the Registered Pledge Law provides for an action addressed to a commercial judge for an execution ordering the sale of the pledged assets.[90] Article 39 of the same law allows designated institutional creditors to seek an order of sequestration of the pledged goods and then to proceed with the sale of those assets as under the classic pledge. The liquidation of the assets is subject to judicial supervision.

The perception of creditors is that the enforcement procedures for the registered pledge are slow and costly. Delays of six months or a year are not unusual in completing this process. As one Argentine study notes: "The slowness and elevated cost of the executions reduces the utility of guarantees in particular the utilization of pledges over inventories and machinery."[91]

One reason why creditors lack confidence in the floating pledge seems to be related to doubts as to whether they will actually be able to liquidate the collateral assets. Inventory subject to a floating pledge may be sold. The registered pledge law does not itself provide for the floating interest to jump to the assets obtained by the debtor when collateral assets are subject to a special priority bankruptcy.[92] When assets subject to a special priority are sold, Article 245 of Ley 24.522 provides that the priority continues in the price obtained or other assets entering the patrimony in replacement of the assets sold. Commentators indicate that this right of real subrogation applies only to determined assets raising a question as to whether it would apply to an asset

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[90] As a result of the deep economic crisis which descended on Argentina in early 2002 emergency legislation suspended enforcement of *hipotecas* and *prendas* for 180 days beginning February 2, 2002. Ley 25.563, art. 9. This emergency moratorium legislation could be lifted or modified at any time.

[91] Leonardo Bleger & Guillermo Rozenwurcel, *Financiamiento a les Pymes y cambio estructural en la Argentina. Un estudio del caso sobre fallos de mercado y problemas de informacion*, 40 DESARROLLO ECONÓMICO 45, 46 (No. 57 Abril-Julio 2000).

[92] Article 3 of the Registered Pledge Law does allow extension of the pledge to "fruits, products, rents" of the pledges assets and to indemnification arising from the disaster, theft or deterioration of the pledged assets.

which is part of a floating pledge.[93] In any case, financers seem to lack confidence in the floating pledge, particularly as to inventory of a business.[94]

The contrast with a car or other motor vehicle subject to a fixed pledge is noteworthy. In this context creditors can feel or be confident that they have a real right in the particular, identified asset which runs with the asset. From a traditional legal viewpoint, a slow and careful scrutiny of claims to a debtor's assets can be seen by the courts as the appropriate way of protecting debtors from false claims of default or privilege. It may even be an unacknowledged form of debtor relief if it allows the debtor in distress more time to come up with the money. Delay is customary in both countries as to real estate. It can be tolerated there since land will retain its value, but personal property assets have a limited life expectancy. Speed in enforcement is a key feature to induce creditors to rely on personal property collateral.

Article 9 provides for flexible and rapid enforcement of non-possessory security interests after the debtor defaults. Upon default the secured party is entitled control of or over money payments being made with respect to accounts, chattel paper, or instruments and may simply apply such collections to its debt.[95] The secured party is also entitled to take possession of tangible collateral (e.g. goods) and may do so either by a judicial process or by self help provided it does not commit a breach of the peace.[96] Self help seizures are typically accomplished by repossession specialists acting as agents of the secured party. In practice, self help repossession occurs mainly as to "big-ticket" consumer items such as cars and boats which are repossessed in very large numbers. It also occurs with the debtor's consent in other contexts. The option of "judicial process" involves a summary judicial proceeding which will authorize a sheriff or similar public official to seize the collateral. These proceedings are not themselves governed by Article 9 and go by different names in different states (e.g. replevin, personal property foreclosure). Whatever the name, these devices allow the secured creditor to liquidate the collateral much more rapidly than in a real estate foreclosure.[97]

Once the secured creditor is in possession, the thrust of Article 9, is to require and allow the creditor to make a disposition of the collateral.[98] Article

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[93] GILBERTO VILLEGAS, *supra* note 20, capítulo III ¶ 4; Santiago C. Fassi & Maracelo Gebhardt, *Concursos y quiebras* 481 (Editorial Astrea 2001).

[94] *See supra* notes 64-67 and accompanying text.

[95] U.C.C. § 9-607 (2001).

[96] U.C.C. § 9-609 (2001).

[97] LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 48 (2000) (secured creditor able to obtain possession within 2 or three weeks).

[98] U.C.C. § 9-610 (2001).

9 allows the secured creditor itself, rather than a judicial officer, to conduct the sale or other disposition. A sale may be arranged privately or may be by auction conducted by the creditor.[99] Given that the disposition is forced, the sale is not required to yield fair market value.[100] But the debtor, as well as any personal guarantor, is entitled to an advanced notice of the disposition, and every aspect of that disposition must be commercially reasonable.[101]

These Article 9 rules address the integrity of the disposition process. They show no concern about the creditor overreaching through the assertion of false claims or interests. Moreover, the Article 9 rules governing the disposition of commercial assets are very general (e.g. "commercially reasonable" disposition). Thus, they give the courts a good deal of discretion in policing the disposition process. If the disposition fails to produce net proceeds sufficient to cover the secured debt, the debtor remains personally liable for the deficiency. It is in the context of suits to recover a deficiency that the courts are often called upon to determine whether the rules of Article 9 have been followed. The U.S. policy of giving discretion to the courts extends beyond calculation of the debt and identification of collateral to policing of the creditor's foreclosure process.

8. *Discrete Security v. Floating Liens*

The Argentine system is well adapted to discrete transactions secured by a single asset of significant value. The Argentine financers well known preference for a *hipoteca* on identified real estate illustrates the type of transaction with which the system is most comfortable.[102] Credit secured by a mortgage on a factory, ranch or home is supported by the *hipoteca.* Similarly, rules for creation, registration and enforcement of registered pledges support business or consumer acquisition of motor vehicles. But this system does not produce "floating lien" financing for small and medium size businesses.[103] Requirements for specific identification of the goods and the debt are inconsistent with a floating lien covering shifting assets such as inventory, receivables and collections.

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[99] U.C.C. § 9-610(c) (2001).

[100] U.C.C. § 9-627 (2001).

[101] U.C.C. § 9-610 - 9-614 (2001).

[102] *See* HEYWOOD W. FLESIG & NURIA DE LA PENA, ARGENTINA: HOW PROBLEMS IN THE FRAMEWORK FOR SECURED TRANSACTIONS LIMIT ACCESS TO CREDIT CENTER FOR ECONOMIC ANALYSIS OF LAW 2 (1996) (most loans from formal sector institutions in Argentina are either secured by a hipoteca or a personal guarantee of some who own real estate).

[103] *See* Flesig & de la Peña, *supra* note 19.

The total volume of pledge transactions seems to be much lower than for security interests in the U.S. Only seven to eight percent of the loan portfolio of Argentine banks is composed on loans secured by *prendas*.[104] This compares with fifteen percent of the private bank loans and over twenty-eight percent of the public bank loans being secured by mortgages.[105] Advertising in Buenos Aires shows banks competing for consumer mortgage loans, not registered pledges. Much of the loan portfolio of Argentine banks is simply unsecured.

Inadequate funding for small and middle size enterprises is a major problem in Argentina.[106] No doubt macroeconomic factors, such as difficulties in funding public debt and changes in the structure of Argentina's banking industry, are factors in the difficulties which these vital enterprises have in obtaining external financing. The inadequacy of the registered pledge to support small and medium size businesses is also suggested by the recent emphasis on other financing techniques. The limitations of personal property security devices provide incentive to use financing devices which do not involve the creation of an interest in assets owned by the debtor. Equipment leasing, factoring of accounts, priorities for accepted commercial invoices, and securitization of receivables all appear as alternatives to security interests in personal property assets of the enterprise.[107] As explained in the next section, these alternatives may not produce the very close monitoring or control of the debtor firm which is typical of "floating lien" financing in the U.S. The dynamic of these financing techniques is different because the debtor does not own the assets—the financer or a third party does. Most notably, the essence of securitization is to build a complete wall of separation between the enterprise which generates the receivables and the entity that purchases those receivables and issues securities backed by them. To appreciate the full dimensions of floating lien financing for small and medium size firms one must examine how it impacts for better or worse—on the closeness of the relationship between financer and debtor firm.

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[104] Alfredo T. Garcia, *Financiamiento hacia las pequenas y medianas empress. El entorno financiero necessario*, 166 *Realidad Economica* 100 (July 1999).

[105] *Id.*

[106] *Id.*; *see also* Leonardo Bleger & Guillermo Rozenwurcel, *supra* note 91; *see* "A La Caza De Capital," *Apertura* 28 (May 2001) (inability to attract bank financing is a major problem for PYMES).

[107] Ley 24.441 (1995) was designed to promote asset securitization in Argentina particularly mortgage-based securitization. *See* JORGE ROBERTO HAYZUS, FIDEICOMISO (Editorial Astrea 2000); Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York, *New Developments in Structured Finance*, 56 BUS. LAW. 95, 129 (2000); Erica Stump, *Securitizations in Latin America*, 8 U. MIAMI BUS. L. REV. 195 (2000).

9. *Impact of Floating Liens on the Debtor-Creditor Relationship*

Under Article 9, it is a "default" which triggers the right of the secured creditor to enforce its security interest by collecting or liquidating the collateral. But Article 9 does not itself define what events will constitute a default. In practice, one of the most vital functions of the security agreement is to spell out in detail the events that will allow a secured party to declare a default and to proceed against the collateral. Agreements normally include events going beyond failure to pay the debt when it is due. Commercial security agreements typically contain elaborate financial covenants and promises concerning the operation of the debtor enterprise. For example, the debtor may promise to maintain a specified net worth. It may promise not to pay dividends while the loan is outstanding. It may agree to limit the compensation to be paid to the principals of the business. It may promise not to engage in mergers or acquisitions without the creditor's consent. Breach of any of these promises would constitute a default allowing the secured party to accelerate the debt and seize the collateral.

The reality of commercial financing under Article 9 is that the financer gains considerable influence over the debtor enterprise. In times of prosperity, declarations of default for reasons other than failure to make required payments or dishonesty on the part of the debtor are rare.[108] But the secured party has the *legal power* to declare such a default and to seize all of the collateral assets covered by its "floating lien" if it decides that it is in its interest to do so. Only by filing a bankruptcy action can the debtor retain assets critical to its continued operation. Thus, the debtor who has violated a "non-payment" provision of the agreement must listen carefully to the advice that its principal secured creditor is giving. Moreover, "non-payment" defaults often trigger negotiations in which the existing financer will press the debtor to find another substitute financer to "take out" the existing creditor, extending funds to pay off the existing creditor, often at a higher interest rate—reflecting the increased risk associated with the enterprise having encountered financial difficulty.

One important policy issue is whether it is desirable for financers to have this type of influence over small and medium size enterprises. It is possible to see this influence as either a positive or negative factor depending on the circumstances. The endeavor may be pictured as a type of "partnership," not in law, but in business practice, in which the secured party and the manage-

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[108] *See* Ronald J. Mann, *The Role of Secured Credit in Small-Business Lending*, 86 GEO. L.J. 1 (1997).

ment of the debtor work together to solve the operational problems that are encountered. Some U.S. theorists see this dynamic as the principal advantages of the Article 9 system.[109] As they see it, the security interest makes the debtor firm behave by giving the creditor the leverage to enforce the terms and conditions of the financing agreement. To this extent, Article 9 floating lien financing tends to blur the economist's distinction between "internal" and "external" financing. On the other hand, the influence of a major financer could be seen as the power to interfere arbitrarily with the operation of the debtor in a way exceeding the expertise of the secured creditor. As we will see, if the "advice" of the secured creditor is too unreasonable, the U.S. firm in trouble always has the option of filing a Chapter 11 bankruptcy reorganization proceeding and thereby suspending for an indefinite period the enforcement powers of the secured creditor.[110] The reorganization option assures that the secured creditor cannot simply impose its will on the debtor firm. No similar checkmate exists in a *concurso* under Argentine law since the holder of a *hipoteca* or *prenda* can insist on enforcement of its interest in such a proceeding with minimal delay.[111] In any case, the Argentine approach of encouraging alternatives to secured credit may promote debtor-creditor relationships which are more distant than is typical under Article 9. Secured credit laws are only one of many factors impacting on the financing patterns which actually emerge in a country, but they can be a significant factor.

10. Interests in "Big Ticket" Consumer Assets

One of the Article 9 success stories in the United State is the facilitation of security interests in cars, trucks, boats and similar "big ticket" items. Security interests are taken in these expensive items both for the collection leverage they afford and for the liquidation value of the collateral assets. There is little doubt that these security interests enable consumers to acquire expensive assets that they would not otherwise be able to buy. The interest rates on these transactions are consistent with proferred rationale that secured credit reduces the cost of credit. Consumer advocates do not disapprove of these "big-ticket" security interests, though they do question whether creditors are too quick to declare defaults and repossess the collateral, and they are concerned that the collateral disposition process under Article 9 provides too little protection for

[109] Alan Schwartz, *Priority Contracts and Priority in Bankruptcy*, 82 CORNELL L. REV. 1396 (1997) (security makes financial covenants effective); Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901 (1986) (creditor serves as financial advisor).

[110] *See infra* Part II.*E*.

[111] *See infra* Part II.*E*.

any equity that consumers may have acquired in these assets.[112] In Argentina the registered pledge provides similar support for acquisition of motor vehicles and other expensive assets which can be described with particularity.

11. Security Interests in the Personal Assets of Consumer Debtors

The informality of the U.S. system together with features of the Bankruptcy Code to be explored in the next part also allow for creation of security interests in lower-priced consumer items which would apparently not be possible or sensible within the Argentine system. There are two primary illustrations of this market impact. One involves the credit card plans of U.S. retailers such as Sears or Tandy.[113] The minimal formalities for a security agreement under Article 9 allow these retailers to take security interests in the assets which cardholders purchase with the use of their cards. The process starts with a conspicuous provision of the credit card application declaring that the applicant grants to the retailer a security interest in all items purchased with the use of the card. The sales invoice which the consumer signs at the time of purchase will also indicate that a security interest is being granted and contain a cross-reference to the terms of the credit card application. Some opinions hold that the credit card application alone is sufficient as a security agreement under Article 9 even though it describes the collateral only in the most general terms such as "all items purchased with the use of the card."[114] Other opinions are willing to piece together a security agreement using what is known as the "composite document" approach. In this analysis, the credit card application can be linked together with the sales invoice giving some indication of the particular items being purchased to satisfy the requirements of a security agreement.[115] These decisions illustrate just how informal the U.S. system can be in practice. There is no requirement that the document creating the security interest be labeled a "security agreement," nor is it essential for the agreement to be expressed in one paper or record. As described in the next part, the

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[112] *See* Andrea Coles-Bjerre, *Trusting the Process and Mistrusting the Results: A Structural Perspective on Article 9's Low Price Foreclosure Rule*, 9 AM. BANKR. INST. L. REV. 83 (2001).

[113] *See* Julian B. McDonnell, *Securing Consumer Credit Card Accounts With Goods Purchased: Celebration of Freedom or Exercise in Bondage?*, 31 UCC L.J. 332 (1999).

[114] *See, e.g.*, Tandy Credit Corp. v. Martinez (*In re* Martinez), 179 B. R. 90, 96-98 (Bankr. N.D. Ill. 1994). *Contra In re* Shirel, 251 B.R. 157 (Bankr. W.D. Okla. 2000).

[115] *See, e.g., In re* Bradel, 1990 WL 86714 (Bankr. N.D. Ill. 1990). These credit card decisions were rendered before adoption of Revised Article 9. The revision for the first time will allow a security agreement to be embodied in an electronic record rather than requiring a writing. In the future, a recorded phone or internet conversation with the debtor may suffice as an Article 9 security agreement. *See* U.C.C. § 9-203 (2001).

whole purpose of the credit card security interest is to pressure the consumer to reaffirm its credit card debt in the event that the consumer files a Chapter 7 liquidation proceeding.[116]

One problem posed by such interests is whether consumers actually understand that they are granting such leverage over assets purchased with the use of the card. No matter how bold the grant of a security interest in a credit card application, will it be read and understood? Bank credit card plans of *VISA* and *MASTERCARD* do not contain a provision for a security interest in goods purchased. Will the typical consumer be aware that if he buys the stereo with a *VISA* card, the debt will be unsecured, but if he uses the Sears card, the purchase price will be secured by the set? Formalities can serve the cautionary function of alerting a debtor to what is actually transpiring. The lack of formality of the Article 9 system may undermine this cautionary policy, as the retailer credit card plans show. Moreover, there is no evidence that interest rates are lower on retailer credit cards (which are secured) than bank credit cards (which are unsecured). In this area of consumer finance, there is reason to question whether the Article 9 system is working as its supporters contend.

Argentine retailers are beginning to issue their own credit cards. But the formality of the Argentine system and the inability of a debtor in liquidation to reaffirm or pay one of its creditors mean that this credit card account will not be secured by goods purchased.

A second questionable context involving security interests in lower-priced consumer assets under U.S. law involves small loans by finance companies to poorer credit risks at higher interest rates. In this context, the loans are not made to enable the consumer to acquire the assets. Instead, security interests are taken in individual assets already owned by the consumer seeking the small loan. In U.S. terms, these interests are "non-purchase money security interests." Since they do not involve a transfer of possession of the consumer assets to the finance company, they are also "non-possessory."

In this area, Article 9 is limited by two federal consumer protection measures. One is the Credit Practices Rule adopted by the Federal Trade Commission in 1985.[117] It overrides Article 9 by outlawing non-possessory, non-purchase money security interests in a sharply defined list of "household goods." The FTC definition of the protected assets is:

> Clothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware, and personal effects

[116] *See infra* Part II.*D*.
[117] FTC Credit Practices Rule, 16 C.F.R. § 444.1(i) (2001).

> (including wedding rings) of the consumer and his or her dependents, provided that the following are not included with the scope of the term "household goods":
> (1) Works of art;
> (2) Electronic entertainment equipment (except one television and one radio);
> (3) Items acquired as antiques; and;
> (4) Jewelry (except wedding rings).[118]

Unlike cars and boats, these consumer necessities have little liquidation value. But to the consumer owner these assets may be precious possessions. Aware of the consumer's strong psychological identification with these personal assets, finance companies prior to the FTC's intervention insisted on security interests in them. Now the taking of such interest in the listed "household goods" is a violation of the FTC's Regulation.

The response by the finance companies to the FTC Regulation testifies to how much lenders value the collection leverage security interests provide. The finance companies now invest the resources to identify specific assets owned by the loan applicant that fall outside the circle of "household goods" as defined by the FTC. They insist on security interests in these non-protected assets as a condition for the small loan and even go to the trouble of filing financing statements to perfect their non-purchase money interests. For example, the lender may take and perfect a security interest in a necklace, a stereo, a personal computer or sports equipment, all for the purpose of being able to threaten repossession if the debtor does not repay the loan as promised.

If the debtor files a bankruptcy action, a second federal restraint on small loan security interests of this type becomes available. Section 522(f)(1) of the Federal Bankruptcy Code allows a debtor to avoid "non-possessory, non-purchase money security interests," which impair an exemption to which the debtor would otherwise be entitled in "household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments or jewelry that are held primarily for the personal, family or household use of the debtor or a dependent of the debtor." This provision is designed to prevent security interests from impairing the "fresh start" which the Bankruptcy Code makes available to Chapter 7 debtors. The listing of assets which can be protected under Section 522(f)(1) is more extensive, but less defined, than the narrow list of personal necessities protected by the FTC. The bankruptcy opinions do not agree as to range of assets protected by Section 522(f)(1). No

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[118] *Id.*

doubt the consumer's necklace is protected as "jewelry," but what of the stereo, personal computer, or sports equipment? Bankruptcy judges in the U.S. disagree as to whether assets like these are essential to a consumer's "fresh start."[119] The Bankruptcy Reform Act of 2001 seeks to limit the security interests which may be avoided under Section 522(f)(1) by defining "household goods" in a manner similar to the FTC's definition.[120]

Argentine consumers seeking small loans face much higher interest rates than their U.S. counterparts.[121] But small loan lending both from formal sector and informal sources is typically unsecured in Argentina. Again the formality of Argentine secured credit law seems to preclude the use of secured devices as to lower-priced consumer goods. The combination of power over a debtor's assets with very high interest rates is exactly the scenario which Argentine law seeks to preclude.

D. Transition

This overview of secured credit law has isolated one major difference in the laws of the two countries: it is easier for creditors to create and enforce interests in the personal property assets of a debtor under U.S. law. The power position of the secured creditor *vis a vis* the business and consumer debtor is thus stronger in the U.S. than Argentina—so long as the debtor does not file an insolvency proceeding. In the following section we compare the insolvency laws of the two countries and discover the opposite orientation. In the United States these proceedings tend to check the power of the secured creditor; in Argentina insolvency proceedings enhance the position of the creditor.

II. IMPACT OF INSOLVENCY PROCEEDINGS ON SECURED CREDITORS

A. Differences in Basic Philosophy

At first glance the Argentine and the U.S. insolvency systems share common features which might lead to the impression that insolvency proceedings present similar environments in the two jurisdictions. In both countries there are distinct rehabilitation and liquidation proceedings. In both

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[119] *See* Julian B. McDonnell, *Regulation of Security Interests in Consumer Assets, in* SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 20.04 (Bender 2001).

[120] Bankruptcy Reform Act of 2001 § 313.

[121] *See Argentine Customers go to Informal Credit Sources*, SOUTH AM. BUSINESS INFORMATION, July 13, 2000 (Deloitte & Touche Study reports monthly rates from 2.6 to 3.5% from banks, 6 to 10% in the informal sector).

jurisdictions insolvency actions produce a moratorium on enforcement of creditor remedies. In both countries the assets included within the jurisdiction of the court and protected by the moratorium initially include collateral assets covered by *hipotecas, prendas*, mortgages or security agreements. And in both countries secured creditors retain a priority status within insolvency proceedings. However, on closer examination it is clear that the manner in which these common principles are implemented is not the same. In this part we explore how differences in the insolvency systems in fact treat secured creditors differently and how these differences critically impact the negotiation process conducted by creditors and debtors.

The differences which we examine here reflect a basic convergence in the philosophy underlying the two systems. Argentina's Ley 24.522 enacted in 1995 was designed to give comfort to creditors who may have felt that other aspects of the Argentine legal order were not friendly to their interests. As one authority has written, "The guardianship of the interest of creditors constitutes the supreme value in Ley 24.522."[122] No knowledgeable observer would make the same comment about the U.S. Bankruptcy Code. It was enacted in 1987 to counter-balance the powerful rights accorded by the state-law Article 9 of the U.C.C. to secured creditors. Its underlying themes are equal treatment of creditors and protection of debtors needing time for either an orderly liquidation or a possible rehabilitation. An individual forced to file a liquidation case is presented the opportunity for a "fresh start" with his post-filing income protected from the claims of pre-filing creditors. Interestingly, it is the Bankruptcy Reform Act of 2001 that would move the U.S. system in the direction of the much more creditor-friendly Argentine law.

B. Types of Proceedings

A most obvious similarity in the laws of the two countries is that both provide for distinct rehabilitation and liquidation proceedings with the possibility of a case commenced in either format being converted into the other. In Argentina both individuals and firms can seek rehabilitation in a *concurso preventive* (literally "preventive agreement"). This title for the proceeding significantly reveals the underlying concept: a *concurso* is a last step effort to save the debtor from a *quiebra* (literally bankruptcy), which is the more severe liquidation proceeding. *Quiebras* may be either voluntary cases filed by the debtor or involuntary cases filed by a creditor.[123] In sharp

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[122] José A. Iglesias, *Consursos Y Quiebras Ley 24.522* p. 22 (Depalma, Buenos Aires 1995).

[123] As a result of the deep economic crisis which descended on Argentina in early 2002,

contrast with the U.S., a high percentage of *quiebras* are involuntary cases filed by creditors who view them as debt collection proceedings. Argentina imposes a condition on the initiation of either a *concurso* or a *quiebra* which has no formal counterpart in the U.S. Following the French and Italian doctrines, a *cesación de pagos* or insolvency is a precondition to opening either type of proceeding.[124] This precondition explains why the proceeding is not initiated by the filing of the petition in Argentina as in the U.S. Instead, the court must declare the *apertura* after being satisfied that a *cesación de pagos* exists.[125] Since a *cesación de pagos* is required, it is not necessary for a number of creditors to join an involuntary *quiebras* petition.[126]

In the United States, a filing will normally be under one of three chapters of the Bankruptcy Code: Chapter 7, a liquidation proceeding for both individuals and corporations; Chapter 11, a rehabilitation proceeding used principally by business debtors; and Chapter 13, a rehabilitation proceeding for individuals with regular income who owe unsecured debts of less than $269,250 and secured debts of less than $807,750.[127] There is no legal precondition that the debtor be insolvent before filing under any of these chapters.[128]

At first glance, the Argentine *quiebra* and the U.S. Chapter 7 seem to be very similar. In theory, both involve liquidation of the debtor's non-exempt assets under the supervision of a *sindico* or trustee. But, as we will see, these proceedings are in practice quite different.

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emergency legislation suspended the filing of *quiebras* for 180 days from February 2, 2002. Ley 25.563, art. 11. This emergency moratorium is designed to protect debtors from the filing of involuntary *quiebras* during the period of economic turmoil.

[124] Ley 24.522, arts. 1, 78. It is possible to submit an extrajudicial agreement with creditors for judicial approval pursuant to Article 69 without a *cesación de pagos*. Historically, *cesación de pagos* has been described as "the state of a *patrimonio* that shows it is unable to face completion of the eligible obligations." Mauro Yadorola, *Algunos aspectos fundamentales de la nueva Ley de Guiebras*, REVISTA CRITICA DE JURISPRUDENCIA n.19 p. 433 (1934). The doctrine has both French and Italian antecedents. The classic Italian formulation, considered authoritative in Argentina is "the state of incapacity of *patrimonio* of the debtor in complete in normal and regular form the obligations that burden it." The requirement of *cesación de pagos* may be eased in *concursos* where the filing of the petition is considered as admission by the debtor that the requirement exists. *See* Juan M. Dobson, *Argentina's Bankruptcy Law of 1995*, 33 TEX. INT'L L.J. 101, 104 (1998).

[125] Ley 25.522, arts. 1, 13.

[126] Ley 25.522, arts. 77, 78.

[127] There are other more specialized chapters. Chapter 9 is a rehabilitation proceeding for municipal corporations. Chapter 12 for family farmers lapsed in 2000. It may be revived by the Bankruptcy Act of 2001.

[128] *See* 11 U.S.C. § 109 (2000).

C. Assets Subject to Insolvency Proceedings

Both Argentine and U.S. law define very broadly the range of assets which are initially subject to the insolvency proceeding. Article 2 of the Argentine law begins with a declaration of *universalidad* stating: "The *concurso* produces its effects on the total patrimony of the debtor, except for legally established exclusions with respect to identified assets."[129] Similarly, the filing of a petition under the U.S. Code creates a bankruptcy estate composed of "all legal or equitable interests of the debtor in property as of the commencement of the case."[130] The U.S. Supreme Court has specifically held that property of the estate extends to collateral assets which are subject to real property or personal property security interests.[131] At least in rehabilitation cases, property subject to a security interest created under Article 9 remains subject to the jurisdiction of the bankruptcy court and the protection of the bankruptcy even if it has been repossessed by the creditor before the bankruptcy filing. This broad reading of property of the estate under U.S. law reflects the conviction that all of the debtor's assets should remain available to support the insolvency proceeding so long as the priority claim of the secured creditor is respected. Note, however, that the U.S. bankruptcy estate is limited to interests which the debtor has as of the filing of the bankruptcy petition. Income earned after the filing is not available to satisfy the claims of creditor. In the case of an individual filing under Chapter 7, that future income will be protected by the discharge from personal liability which the individual debtor normally obtains in Chapter 7.[132]

The debtor's situation is much different in a *quiebra*. The opening of the *quiebra* places the administration of the debtor's *patrimonio* in the hands of the *sindico*.[133] The debtor is placed in a state of incapacity *inhabilitación* which normally lasts for a year from the opening of the bankruptcy.[134] Assets acquired by the debtor (including earnings) during the period of *inhabilitación*

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[129] Ley 24.522, Tit. 1, Art. 1. Though the statute does not expressly say so, it is clear that principle of *universalidad* also applies in a *quiebra*. "Desde el punto de vista del deudor, la concursalidad comporta que la regulación se produzea *todos* sus bienes, porque de fodos sus bienes el deudor debe extraer los medios para liberarse de las deudas" Salvatoro Satta, *Instituciones del Derecho de Quiebra*, 5 no. 2 (Ejea Buenos Aires 1951). *See* SANTIAGO C. FASSI & MARCELO GEBHARDT, CONCURSOS Y QUIEBRAS 1 (Editorial Astrea. Buenos Aires 2001) [hereinafter FASSI AND GEBHARDT].

[130] 11 U.S.C. § 541 (2000).

[131] *See* United States v. Whiting Pools, Inc., 462 U.S. 198 (1983).

[132] 11 U.S.C. § 727 (2000).

[133] Ley 24.522, arts. 15 and 107.

[134] Ley 24.522, art. 236.

are swept into the *quiebra* and are available to satisfy pre-bankruptcy creditors. Only assets acquired after the end of the *inhabilitación* are protected from creditor's claims. This differing treatment of the debtor's post-petition earnings illustrates how severe the *quiebra* is in comparison with a Chapter 7.

From the Argentine perspective the opportunity of obtaining a discharge of personal liability and gaining a "fresh start" in which the future income of the debtor is protected (which is available in Chapter 7 in the U.S.) without any precondition of insolvency seems to invite abuse of the bankruptcy process. Indeed, it is objection to free access to Chapter 7 in the U.S. which has been the principal concern leading to the proposed Bankruptcy Reform Act of 2001 now before the U.S. Congress. The sponsors of this legislation believe that individuals have been too ready to file Chapter 7 proceedings in order to walk from unsecured bank credit card obligations. Thus, the Bankruptcy Reform Act of 2001 would for the first time impose a "needs" test for individuals to qualify under Chapter 7.[135] Individuals failing this test will be forced to file under Chapter 13 and present plans proposing to repay a portion of their unsecured debt in installments.

D. Retaining Collateral in Liquidation Proceedings

The administration of the debtor's assets by the *sindico* deprives a debtor in a *quiebra* of the capacity to pay selected creditors, secured or unsecured. Payments made by a debtor are ineffective.[136] The final result is that the debtor in *quiebra* has no capacity to hold on to collateral assets by selectively paying the secured creditor. Take, for example, the case of a car secured by a registered pledge. Unless the creditor is sleeping on its rights, the creditor on the defaulted car debt will promptly submit its claim for verification and

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[135] The formula calculated to restrict access to Chapter 7 is complex. It has been summarized as follows:

> A Chapter 7 filing will be presumed to be abuse if the debtor's net income after qualifying expenses, multiplied by sixty exceeds the greater of 25% of nonpriority unsecured claims or $6,000, or totals more than $10,000 without regard to the amount of unsecured debt. The presumption is not available if the debtor's current monthly income is less than the median income for the state. The U.S. Trustee is to file a report with the court within ten days after the meeting of creditors as to whether the debtor's case would be presumed to be an abuse.

Randolph J. Haines & William L. Morton III, *Summary of the Bankruptcy Reform Act of 2001*, *available at* 2001 WL 533346 (2000).

[136] Ley 24.522, Art. 126.

demand the sale of the car. There is no procedure or practice by which the debtor can retain an asset of this type after initiating a *quiebra*.

A debtor in Chapter 7 in the United States stands in a contrasting position. Section 704(1) of the U.S. Bankruptcy Code charges the trustee in a Chapter 7 case to "collect and reduce to money the property of the estate." In practice, however, there is typically no physical seizure of collateral assets in Chapter 7 cases filed by an individual. The debtor will initially file schedules disclosing his debts and the collateral assets which secure them. At a meeting of creditors twenty to forty days after the filing of the petition the debtor may be questioned under oath by the trustee.[137] In most cases, the trustee will decide that the debtor has no equity in any of the assets subject to security interests and will simply abandon them. Most Chapter 7 cases filed by individuals are "no assets" cases. This abandonment removes the assets from the bankruptcy estate and the protection of the bankruptcy stay.[138]

The debtor is free to continue paying a secured creditor holding an interest in a precious asset such as a house or car. At the very least, payments can be made from exempt assets or post-filing earnings. Under present law, some circuits give the debtor the right to retain the collateral simply by keeping its payments current to the secured creditor.[139] This procedure is known as "ride through" or "reinstatement." Even in circuits which do not recognize "ride through" as a statutory right, secured creditors often allow debtors to "ride through" where the collateral is a big ticket item such as a car or a boat. The debtor emerges from bankruptcy with a discharge of the debt. The debtor can no longer be sued. But if after the termination of the bankruptcy the debtor defaults on the debt, the creditor may still repossess and sell the asset. The creditor contents itself with a non-recourse obligation because the car or boat has significant resale value

If the collateral consists of less expensive household goods, the creditors whole objective is to press for a reaffirmation agreement.[140] Under such an agreement the debtor agrees to continue paying the creditor and the creditor allows the debtor to hold on to the precious asset. Security interest taken in goods purchased under store credit card plans illustrate this context.[141] The

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[137] Practicing Law Institute, *Liquidation Under the Bankruptcy Code, Chapter 7*, 776 PLI/COMM. 917, 3 (1998).

[138] *See* 11 U.S.C. § 554 (2000).

[139] *See* Richard E. Coulson & Alvin C. Harrell, *Consumer Bankruptcy Developments*, 56 BUS. LAW. 1265, 1266 (2001) (collecting case authority on "ride through").

[140] Reaffirmation agreements are regulated by Section 524(f) of the Bankruptcy Code. 11 U.S.C. § 524(f) (2000)

[141] *See supra* Part I.C.*11*, at 423.

retail creditor does not really want to liquidate second-hand consumer goods because they do not have significant resale value. The security interest is taken so that the creditor will be in a position to induce the debtor to forego a discharge of the creditor's debt. The whole purpose of taking such a security interest whether by a retailer or loan company is to be able to press the debtor to reaffirm in bankruptcy.[142] The interaction of secured credit and insolvency law results in this pattern of market behavior. Millions of reaffirmations occur in each year in the U.S. The Bankruptcy Reform Act of 2001 will resolve the current judicial split on "ride-through," eliminating any right to a ride-through over the objection of the secured creditor. This change is designed to put additional pressure on consumers to reaffirm in order to retain possession of items which are precious to the individual owner, even though they have no significant resale value. There is no recognized practice of "ride-through" or reaffirmation in individual *quiebra* cases in Argentina. Once the *quiebra* is opened, the debtor has nothing to negotiate. A different interaction exists between secured credit and insolvency law producing a different market place result.

E. Length of the Moratorium

When insolvency proceedings begin, both Argentina and the United States impose a moratorium on the exercise of remedies by secured creditors.[143] But a most critical difference is in the length of the moratorium. In Argentina the creditor secured by a *hipoteca* or *prenda* must present its claim for verification by the judge of the *quiebra* or *concurso*.[144] But after verification in a *quiebra* a secured creditor is entitled to an immediate sale of the collateral assets.[145] Only the *sindico*, with the approval of the judge, is able to pay the claim of a secured creditor and thereby block the immediate disposition of the collateral assets.[146] In a *concurso*, Article 24 of Ley 24.522 permits the judge to order a temporary suspension of the sale in case of necessity and urgency. But this

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[142] *See* Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709 (1999).

[143] Ley 24.522, arts. 21, 125; 11 U.S.C. § 362 (2000).

[144] Ley 24.522, arts. 14, 35, 126. The process of verification is described in Articles 32-38 of Ley 24.522. According to Ferrer, verification determines, "la existencia, cuentía, prelación y grado de los créditos." FERRER, *supra* note 35, § 29.

[145] Ley 24.522, arts. 126, 209. According to Ferrer: "Los acreedores hipotecarios no necesitan esperar realización de los bienes en el proceso general, creando el deudor ha sido declarado en quiebra concurso civil, sino que podrían pedir la inmediata venta del bien grauado, para que se paguen sus creditors." Ferrer § 41.

[146] Ley 24.522, art. 126.

suspension may not exceed ninety days. If no suspension is ordered, or if the ninety day period expires, the unpaid secured creditor may then insist on the sale of the real or personal property subject to its interest. All of this is in keeping with the general theory of the *concurso*. In this proceeding the debtor is seeking to reach an agreement with its unsecured creditors. For the most part, secured creditors are not affected by the *concurso*. The debtor may propose an agreement which includes secured creditors, but all of them with unpaid claims must consent to the agreement.[147]

In contrast, the stay under Section 361 of the U.S. Bankruptcy Code may remain in effect indefinitely so long as the creditor is "adequately protected."[148] The creditor will be adequately protected so long as either the total value of its collateral is not declining or the creditor is compensated (by payments or substitute collateral) for any decline in value of the collateral.[149] The creditor generally has no right to insist that assets subject to an Article 9 security interest on a real estate mortgage be sold so long as it is adequately protected. Even in a Chapter 7 case, the stay may be continued so long as the debtor has an equity in the collateral assets. In Chapter 7 the trustee may sell the assets, paying the secured creditor first from the proceeds of the sale.[150] But the difference is more pronounced in rehabilitation cases. In Chapter 11, the stay may force the secured creditor to standby for years so long as the bankruptcy judge believes that the secured creditor is adequately protected and that a reorganization is feasible. The Bankruptcy Code gives the judge great discretion in deciding how long the secured creditors will be forced to wait so

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[147] Ley 24.522, art. 44.

[148] U.S. Bankruptcy Code §§ 361, 362(d). Even if the creditor is adequately protected, the stay will be lifted in Chapter 11 if the court is convinced that an effective reorganization is not feasible.

[149] The ways of adequate protection enumerated in Bankruptcy Code § 361 are merely illustrative. The courts also find that adequate protection exists when there is an "equity cushion" i.e. the value of the collateral significantly exceeds the amount of the secured debt. *See* Peter F. Coogan & Julian B. McDonnell, *The Impact of Bankruptcy on Secured Financing, in* SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 9.06(b) (Bender 2001). Thus, where collateral is worth significantly more than the debtor, the creditor is adequately protected without any action on the debtor's part. Likewise, where the debtor continues to operate in Chapter 11, a creditor with a "floating lien" on its assets will be adequately protected so long as the total value of the collateral pool does not decline. Section 552 of the Bankruptcy Code tends to assist the debtor in providing adequate protection by freeing assets acquired by the debtor post-petition from the reach of pre-petition security agreements. For example, the debtor in Chapter 11 may offer the creditor a security interests in post-petition accounts to compensate it for the loss of cash collateral being used by the debtor to pay employees, suppliers, etc.

[150] 11 U.S.C. § 363(b)(1) (2000).

that the reorganization may be attempted. The standard academic criticism is that bankruptcy judges are too reluctant to bring the process to an end and liquidate the firm.[151] The defense of the prolonged stay is that it operates to preserve the going concern value of the financially troubled firm. A single secured creditor cannot provoke a premature liquidation of the venture.[152]

This difference in the length of the moratorium has important consequences for the negotiations between the creditor and its debtors that start at the beginning of the *concurso* or Chapter 11 and that continue throughout the case. Assume that the debtor firm owns real estate or machinery which is essential for the continued operation of the enterprise. In Argentina the debtor must persuade the creditor having a *hipoteca* or *prenda* on those assets to allow the debtor to continue to use the collateral beyond the ninety day period. The secured creditor must be convinced that its interests are served by the continuation of the *concurso* rather than by the immediate liquidation of the collateral. But when the firm is insolvent a typical assessment of interest by secured creditors is to favor liquidation of the collateral.[153] The secured creditor must be convinced that postponement will maximize its return in the long run. Normally, this means that the holder must be persuaded that there is a very significant probability of the *concurso* succeeding. The debtor is constrained as to the riskiness of any proposals it may make. It is particularly difficult to see how a fully secured creditor—holding collateral worth more than its debt—will conclude that it should postpone execution of its rights. Moreover, all secured creditors with interests in essential assets must consent to the continuation of the *concurso*. But in the U.S., the debtor does not fear being immediately shut down by a single secured creditor with an interest in essential assets. It can propose a plan most attractive to the creditor or creditors to which it will look for future financing—holding other creditors at bay through the provision of adequate protection.

The continuing protection of the debtor's assets by the stay is not simply a passive matter under U.S. law. A debtor in Chapter 11 may continue to operate the business.[154] The debtor has the general right—always subject to

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[151] *See* George G. Triantis, *Financial Slack Policy and the Laws of Secured Transactions*, 29 J. LEGAL STUD. 35, 67 (2000); G. Eric Brunstad Jr. & Mike Sigal, *Competitive Choice Theory and the Broader Implications of the Supreme Court's Analysis in Bank of America v. 203 North LaSalle Street Partnership*, 54 BUS. LAW. 1475, 1480 (1999) (stating the traditional view is that Chapter 11 is a "court-driven, debtor-protective regime dependent on equitable sensibilities of the bankruptcy judge.").

[152] *See* Lucian Arye Bebchuk & Jesse M. Fried, *A New Approach to Valuing Secured Claims in Bankruptcy*, 114 HARV. L. REV. 2386, 2396 (2001).

[153] *See* Brunstad & Sigal, *supra* note 151, at 1482.

[154] 11 U.S.C. § 1108 (2000). In Chapter 13 a wage earner's car is also likely to be protected

adequate protection—to continue to use or even to sell the collateral in the ordinary course of its business.[155] Where it is essential to the reorganization, the court may even order the creation of a security interest equal to or superior to the rights of existing creditors.[156] Often a principal motive for filing a Chapter 11 proceeding is to clear the way for "post-petition" financing to be provided to the debtor-in-possession either by an existing creditor or new creditor-assured that it will enjoy a higher priority than pre-petition financers of the debtor. There is no similar possibility under Argentine law for post-petition financing which would displace the priority of existing creditors. As a practical matter, this difference is likely to limit the group of creditors potentially interested in financing the debtor's operations in the *concurso* to those who already hold *hipotecas* or *prendas* on its assets.

F. Modification of Secured Obligation

Under Argentine law the debtor in a *concurso* has no right to judicial approval of an arrangement which will modify a secured obligation over the objections of its secured creditors. In the United States, however, a "cramdown" of secured creditors is possible in Chapters 11 and 13.[157] A "cramdown" allows the terms of the debt obligation to be changed by the court despite the objection of the creditor. A number of involved requirements must be satisfied before a court may approve a "cramdown," and they vary somewhat from chapter to chapter. In all events, the plan must provide for payments to the creditor of the present value of its allowed secured claim. Under present law, the allowed secured claim cannot exceed the value of the collateral.[158] Thus, the "basic tenet of bankruptcy law [is] that the secured creditor has the right to receive the value of its collateral (up to the amount owed)."[159] It is in this way that the U.S. scheme ultimately protects the priority of the secured creditor. But the payments need not be in one lump sum. The plan may propose a stream of payments over a number of years. The extent of modifications possible in Chapter 11 "cramdown" has been summarized as

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by the stay. His retention of the car is likely to be deemed to be essential for continued employment in most contexts—given that public transportation is either totally unavailable or a dismal option in most U.S. locations.

[155] 11 U.S.C. § 363(c)(1) (2000).

[156] 11 U.S. Bankruptcy Code § 364(d)(1) (2000). To this extent, the Bankruptcy Code displaces the first-to-file or perfect (FTOP) rule of priority under Article 9. *See supra* Part I.*C.4*, at 413.

[157] 11 U.S.C. §§ 1129, 1325 (2000).

[158] *See* 11 U.S.C. § 506 (2000); *see also In re* Maldonado, 46 BR 497 (B.A.P. 9th Cir. 1984).

[159] Bebchuk & Fried, *supra* note 152, at 2395.

follows, "The modifications imposed on secured creditors, may, among other things, do the following: modify lien covenants, reinstate mortgages on the verge of foreclosure, change interest rates, stretch out principal payments twenty years or more, and substitute new collateral for existing collateral."[160] It is the fear that the bankruptcy judge may use his discretionary authority to modify the secured obligation that gives creditors powerful incentive to negotiate changes in debt arrangements which give a debtor firm a better chance to survive. "The threat of cramdown gives the debtor the most effective tool in its belt."[161] No similar incentive exists under Argentine law.

The most common "cramdown" occurs in Chapter 13. Individual wage earners are now able to retain cars subject to Article 9 security interests by proposing to pay the present value of the car (not the secured obligation) in installments over the life of their Chapter 13 plan. This alternative is likely to be more attractive than a reaffirmation agreement in a Chapter 7. The Chapter 13 case, as well as its commercial Chapter 11 counterpart, becomes a negotiating arena. Actual court approved cramdowns are unusual. The treatment of most secured claims is settled by negotiation. "Skill at negotiating value, monthly payment, and interest rate will determine course. . . . (for the secured creditor) success in most Chapter 13 cases."[162] A wage earner's only chance to negotiate about retaining a car in Argentina would be in a *concurso*, and even there the creditor has all the cards: if it prefers, it can insist on liquidation of the car.

Under present law a Chapter 13 car cramdown is facilitated because the debtor only needs to pay the depreciated value of the car in installments. The Bankruptcy Reform Act of 2001 has two changes which will make such cramdowns more difficult to negotiate in the future. At present the debtor may "strip down" the security interest incident to a Chapter 13 plan by bifurcating an undersecured creditor's interest into secured and unsecured components. The plan payments need only cover the secured claim which is measured by the depreciated value of the car or other assets. The Reform Act will prohibit such bifurcation in two circumstances where the creditor has financed the acquisition of the consumer asset.[163] One is in respect to a motor vehicle

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[160] Jack Friedman, *What Courts Do To Secured Creditors in Chapter 11 Cramdown*, 14 CARDOZO L. REV. 1495, 1496 (1993). The 20 year stretch out referred to in this text refers to an obligation secured by real estate. When the collateral is in personal property, the stretch out period may not exceed the useful life of the collateral. *Id.* at 1522.

[161] 3 DAVID G. EPSTEIN ET AL., BANKRUPTCY § 10-17 (West 1992).

[162] 1 KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY §§ 3.87 (2d ed. John Wiley 1994).

[163] Bankruptcy Reform Act of 2001 § 306(b), *supra* note 2. Resolving a much debated issue, the Reform Act will require in other cases that personal property be valued at replacement value

acquired for personal use of the debtor within three years of the filing of the petition. The second is with respect to other things of value acquired within one year of the filing. In these cases the Chapter 13 plan will be required to pay the present value of the secured obligation, not the value of the car. Negotiations as to car or other asset value will no longer be required in these two Chapter 13 contexts. The statutory details as to requirements for cramdowns shape the negotiation process under both Chapter 11 and 13. The Reform Act would give the creditor more negotiating leverage in common Chapter 13 situations.

But even if these changes are made, issues of valuation will still dominate the U.S. bankruptcy process. The bankruptcy court will continue to exercise the vital power in fixing the value of the collateral for purposes of determining whether the creditor is adequately protected so that the stay and reorganization may continue. It will likewise have the crucial valuation decision in determining whether a Chapter 11 plan adequately covers the priority of the secured creditor.

G. Maintaining Equal Treatment of Creditors by Invalidation of Pre-Bankruptcy Transfers

Both Argentine and U.S. law recognizes that as a debtor firm struggles to overcome economic and financial difficulties it may fall into irregularities that adversely and unfairly impact on the bankruptcy estate. Equal treatment of creditors who are similarly situated is a general principal of the bankruptcy systems of both countries. Both countries therefore recognize the need to scrutinize actions which benefit a particular creditor in the period before the initiation of insolvency proceeds. In Argentina the need to maintain the *patrimonio* of the debtor as a "common pledge" of creditors is felt with particular strength and may be enforced through diverse proceedings including the bankruptcy revocation action.[164] It allows revocation of acts declared to be ineffective under Articles 118 and 119 of Ley 24.522. In the United States, pre-bankruptcy transfers are subject to avoidance under Section 547 (preferences) and Section 548 (fraudulent conveyances).

In the United States, the exposure of secured creditors under Section 547, the voidable preference provision, is defined and delimited. For one thing, the trustee can normally only attack transfers made by the debtor in the ninety day

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defined as "the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined."

[164] SAÚL A. ARGERI, LA QUIEBRA Y DEMÁS PROCESOS CONCURSALES AT TOMO II 184-185 (Editora Platense, La Plata 1972).

period before the bankruptcy filing, though for "insiders" of the debtor, this period is extended to one year. Transfers either in the form of payments or creation or perfection of security interests may be avoided under Section 547 only when a number of conditions are satisfied. For example, the debtor must be insolvent, the transfer must be for an account of an antecedent debt, and the transfer must operate to improve the creditor's position. Fraudulent conveyances under Section 548 are less precisely defined but seldom impact institutional financers. If a financially troubled debtor transfers assets for less than fair equivalent value, a fraudulent conveyance may be found.

In contrast, Argentine law recognizes an indefinite period of suspicion which begins with the initial date of the *cesación de pagos* and runs to the sentence of bankruptcy. This fixing of the initial date of *cesación de pagos* is a critical step in Argentine bankruptcy proceedings because it determines which *hipotecas* and *prendas* may be subject to revocation. This initial date cannot be more than two years before the sentence of quiebra or more than two years before the presentation of the debtor in a *concurso preventivo* in the case of a *quiebra* preceded by a *concurso preventivo*.[165]

Article 118 of Ley 24.522 catalogs the acts within the period of suspicion which are absolutely ineffective with respect to the mass of creditors without regard to the knowledge of the creditor. Gratuitous transfers within the period are ineffective under Article 118 as are fraudulent conveyances under U.S. Code Section 548. Of more importance for creditors is Article 118(3), invalidating "formation of a *hipoteca* or *prenda* or any other preference with respect to an unmatured obligation that originally did not have this guarantee." This provision deals with transactions similar to those addressed by U.S. Code Section 547. Both provisions aim to prevent the securing of unsecured obligations in the period before bankruptcy. But the preference period may be a longer one in Argentina because the *cesación de pagos* may be fixed at an earlier date.

Article 119 of Ley 24.522 addresses acts which are relatively ineffective in light of the subjective knowledge of the creditor as to the *cesación de pagos*.[166] Under this provision, other acts prejudicial to creditors are ineffective if the party dealing with the debtor knows of the *cesación*. Thus, it appears that a creditor taking a *hipoteca* or *prenda* with knowledge of the *cesación* acquires an interest which may be invalidated in subsequent bankruptcy proceedings.

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[165] Ley 24.522, Article 116.

[166] ARGERI, *supra* note 164, at 200.

III. CONCLUSION

A. Core Values and Attitudes

Placing the secured credit and insolvency laws of Argentina and the United States side by side enables us to see more clearly the core values and attitudes which shape each system. Contrasting ways of viewing secured credit transactions are apparent. In each jurisdiction, there is a prevailing legislative "mindset," drawn from the collective experience and not in any way subject to empirical verification, which operates beneath the doctrinal surface. In Argentina, traditional concerns of legal scholars shape this mindset. Creditors are seen as a suspect group. Fear of fraud and overreaching is palpable. The judicial process, left to its own, cannot be relied upon to suppress misconduct. Substantive rules and processes must be designed to protect the debtor and third parties. Privileged status for one creditor is "exceptional." These are the core values and attitudes which produce formal documentation and recording requirements for *hipotecas* and *prendas*.[167] They are reflected in the slowness of the enforcement process for these security devices,[168] and in policing of transfers made during the period of suspicion.[169]

Once insolvency enters the picture, the debtor joins the creditor in the suspect circle. In a liquidation proceeding, the debtor is deprived of control of his assets for a period of *inhabilitación*.[170] In seeming contradiction to doubts about *hipotecas* and *prendas* in the first place, the creditor armed with such a real guaranty is now given the right to insist on liquidation of the collateral assets even if that means that the reorganization of the enterprise must be abandoned.[171] Judges are not given the task of balancing the competing interests of the debtor firm, the secured creditors, and the collective group of unsecured creditors.

In the United States, transactional lawyers actually engaged in financing transactions play a critical role in shaping Article 9. In their world view the enterprise mentality preempts all other concerns. In the United States, making money is more fun than suppressing fraud. Anyway, creditors, by and large, are good guys—if not by nature, then under the "discipline" enforced by the free market. Make their life easy—that will translate into more and cheaper credit for businesses and consumers alike. This is the view of secured credit

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[167] *See* Part I.*C.2* and *3*.
[168] *See* Part I.*C.7*.
[169] *See* Part II.*G*.
[170] *See* Part II.*C*.
[171] *See* Part II.*E*.

which has resulted in Article 9 of the U.C.C. and now supports the effort to sell its basic principles to the world. The notion that too much credit might be a bad idea in some circumstances never seems to have occurred to U.S. policymakers. Even when the U.S. doctrine seems to "flip-flop" by favoring debtors in bankruptcy, that change can be explained in terms of an enterprise preference. In insolvency cases, it is necessary to check the enforcement powers of the secured creditor in order to give the enterprise the opportunity to reorganize. Rapid liquidation in reorganization cases threaten going concern value.[172]

Cutting across these themes is a different attitude towards the role of judges. The U.S. system expresses more confidence in the capacity of judges to evaluate evidence, to detect and suppress misconduct and to balance competing interests in light of general legislative formulas. Judges can be relied on to fix the amount of the secured debt and the specific assets covered by the security interest.[173] Judges can determine whether a disposition of collateral is "commercially reasonable" and whether a secured creditor is "adequately protected."[174] Argentine law is not comfortable with this degree of judicial activism. It prefers proof by public document and specific directions as to what judges are or are not to do.[175]

The ultimate reasons for these differing views about what judges should do in these areas of law are difficult to determine. Are we talking about differing orientations of the civilian and common law systems in general? Is the political sensitivity of the debtor-creditor relationship a factor which colors this situation? U.S. bankruptcy judges are federal judges who hear only bankruptcy cases allowing them to develop expertise in highly technical matters. But outside of Buenos Aires bankruptcy cases in Argentina are heard by provincial judges sitting on courts of general jurisdiction. Are the commercial interests of Buenos Aires reluctant to trust their fate to provincial judges? A myriad of factors could be at work in this difference in the two systems. Whatever they may be, the underlying difference in attitude toward judicial discretion is relevant in assessing the practicality of proposed legislative changes.

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[172] *See* Part II.*E*.
[173] *See* Part I.*C.5*.
[174] *See* Part I.*C.7* and II.*E*.
[175] *See* Part I.*C.5* and II.*E*.

B. Evaluating Proposed Legislative Changes

Comparing how the secured credit systems of Argentina and the United States operate both when the debtor is in and outside of insolvency proceedings also provides a perspective for evaluating proposed changes in the systems. The comparison enables us to appreciate the practical importance of two aspects of secured credit which we have always known at least in a detached, theoretical way. One constant is how powerful the practice of securing credit with an interest in assets owned by the debtor can be. Security interests in a debtor's assets are valued and feared precisely because of the immense power which they afford. The second constant is that the legal rules governing creation and enforcement of security interests—including the rules of insolvency proceedings—are a significant influence on the commercial practices that develop within a particular country. Two examples stand out. First, the informality of Article 9's system for creation of security interests *allows* U.S. retailers to take security interests in goods purchased with the use of their credit cards.[176] The legal possibility of inducing a consumer in Chapter 7 to agree to a reaffirmation agreement thus foregoing a discharge of their debt obligation to the retailers gives retailers incentive to take such security interests. Retailers know that the consumers personal identification with goods purchased may lead them to reaffirm even when reaffirmation is improvident from a calculated economic viewpoint. Neither of the legal factors supporting credit card interests exist in Argentina, and retailer credit cards emerging there are not yet secured by goods purchased.

Second, the Argentine law of registered pledges does not support "floating lien" financing for small and medium size enterprises as does U.C.C. Article 9. The need with registered pledges to identify with particularity the debt and the collateral assets along with slow enforcement procedures inhibit secured financing of firms in Argentina.[177] Small and medium size firms in Argentina do not have the close working relationship which their U.S. counterparts have with their financers. Argentine firms are encouraged to turn to other financing devices such as equipment leasing and securitization which do not give the financer an interest in the assets of the firm.

Given the need to generate more external financing for small and medium size enterprises, it is likely that Argentina will be under continuing pressure to make changes in its secured credit laws governing commercial financing. Whether through changes in the law of registered pledges or the introduction

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[176] *See* Part I.*C.11*.

[177] *See* Parts I.*C.8* and *9*.

of a new security device, changes may be made to encourage credit secured by inventory and receivables of business firms. Care must be exercised in the implementation of any such changes with respect to their impact in insolvency proceedings. To combine floating lien financing with the present right of the registered pledge holder to insist on liquidation of assets in a *concurso* would not be appropriate. In the United States, if the secured creditor becomes too unreasonable, the debtor firm has the option of filing a Chapter 11 and indefinitely suspending the right of the secured creditor to force a liquidation of collateral assets. It is possible to live with the power which the Article 9 security interest creates precisely because Chapter 11 (a Chapter 13 for wage earners) provides a means of checking that power. Current insolvency laws in Argentina do not similarly checkmate creditors with real guaranties. Any introduction of a more effective system of security devices for personal property must be accompanied by some additional restraint on secured creditors in insolvency proceedings.

But at this point the legislative task could be daunting indeed. A vague standard of forcing secured creditors to stand by so long as they are "adequately protected" is unlikely to appeal to Argentine policy-makers because it would involve giving an unacceptable discretionary power to the judges.

In the United States a different policy caution is in order. Except as otherwise constrained by the Bankruptcy Code, the secured creditor in the U.S. enjoys a very strong power position *vis a vis* the debtor. Moreover, the stark informality of the Article 9 system allows any agreement to be easily secured. Consumer obligations of all types—not just for very expensive items—can and will be secured. Business enterprises are likely to come to bankruptcy with all of their assets secured. Today it is the retailer credit card plan; tomorrow it will be the recorded internet conversation. Thus, reinforcing the secured creditor's position in bankruptcy is likely to have a greater practical impact on the debtor's situation in bankruptcy in the United States than it would in Argentina and other countries. For example, if the consumer debtor is pressed to reaffirm all of its secured obligations, little may be left of the "fresh start" policy no matter how limited the debtor's resources. Correspondingly, if the principal secured creditor has the power to veto bankruptcy reorganizations, there will be no restraint on the exercise of its Article 9 powers. Secured credit is a powerful tool. As James Madison himself emphasized so strongly, unrestrained power invites abuse.