THE FUNCTIONAL METHOD, SYSTEM-NEUTRALITY AND THE FINANCIAL COLLATERAL ARRANGEMENTS DIRECTIVE

OBIORA GODWIN EZIKE
LL. B (HONS) LL.M

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School of law
College of Social Sciences
University of Glasgow

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ABSTRACT

The thesis considers whether, as proffered by the functional method of comparative law, legal institutions can be defined in a system-neutral way in terms of specific effects. To address this question, the thesis uses EU directives, particularly the Financial Collateral Arrangements Directive, as a reference to test this assumption of the functional method. Thus, the thesis begins by demonstrating how the functional method is behind the legislative process of EU directives generally. It is argued that because directives are binding as to the results to be achieved, there are presumptions that implementing legal institutions in the Member States are functionally equivalent and give rise to the same effects. Thus, because they are equivalent, there is a presumption that, at the level of directives, it is possible to formulate system-neutral norms which are not tied to any national legal system. Against this background, the thesis considers the definitions of a title transfer financial collateral arrangement (TTFCA) and a security financial collateral arrangement (SFCA) in the Collateral Directive. An investigation is carried out to identify if the specific concepts and ideas (e.g. full ownership; ownership of financial collateral; possession and control, 'by way of security' etc), as presupposed by the Directive, are indeed system-neutral as suggested by the functional method. In the examination of each of these concepts and ideas, the argument was persistently made in the chapters that although there are functional similarities between legal institutions across the systems, these institutions and concepts can only be seen within a doctrinal context. In this light, in all of the cases considered, it was demonstrated that the concepts or presuppositions contained in the Collateral Directive: a) implicitly endorse some doctrinal principle at the expense of other equally valid principles in contravention of the supposed system-neutrality of the concepts; and b) that most of the functional criteria or effects set out in the Directive are only meaningful when seen within a doctrinal context, rather than from the literal, outsider perspective supposedly adopted by the Directive in line with the functional method. The findings in the thesis generally upholds the criticisms against the functional method that it does not provide tools to understand doctrinal institutions; defines institutions without any objective criteria; and is itself formalistic and doctrinal — in contravention of its own tenets.

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Conveyancing and Feudal Reform (Scotland) Act, 1970.

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Financial Collateral Arrangements (Amendment) Regulations 2009 (SI 2009/2462)

Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010 (SI 2010/2993)

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AUTHOR'S DECLARATION

"I declare that except where explicit reference is made to the contribution of others, that this dissertation is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution."

Printed Name_____

Signature _____

ABBREVIATIONS

TTFCA	Title Transfer Financial Collateral Arrangement
SFCA	Security Financial Collateral Arrangement
FCAR	Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226), as amended by the Financial Collateral Arrangements (No 2) Regulations (Amendment) Regulations 2009 (SI 2009/2462) and the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010 (SI 2010/2993)
Akkermans, 'EU Dev of Property Law'	Bram Akkermans, 'The European Union Development of European Property Law' (2011) 30 Maastricht European Private Law Institute Working Paper 1 <available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1888294>
Collateral Directive	Council Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements [2002] OJ L168/43 as amended by Directive 2009/44/ EC of 6 May 2009 on financial collateral arrangements as regards linked systems and credit claims [2009] OJ L146/37
EC, 'FAQ'	European Commission, 'Proposed Directive on Financial Collateral Arrangements – Frequently Asked Questions'(Memorandum) (2001) Memo/01/108
EC, 'Proposal'	European Commission, 'Proposal for a Directive of the European Parliament and of the Council on Financial Collateral Arrangement', COM (2001) 168 final
EC, 'Proposal for Amendment'	European Commission, 'Proposal for a Directive of the European Parliament and of the Council amending Directive 98/26/EC on Settlement Finality and Directive 2002/47/EC on Financial Collateral' COM (2008) 213 Final
EFMLG, 'Proposal'	European Financial Markets Lawyers Group (EFMLG), 'Proposal for an EU Directive on Collateralisation' (June,2000), 7 <http://www.efmlg.org/Docs/Documents /2000%20June%20EFMLG%20Proposal% 20for%20an%20EU%20Directive% 20on%20Collateralisation.pdf>

EFMLG, 'Statement'	European Financial Markets Lawyers Group (EFMLG), 'Statement on a Proposal for a Directive on Financial Collateral (Com (2001) 168)' (2001), 10 <http://www.efmlg.org/Docs/Documents/EFMLG%20Statement%20on%20a%20Proposal%20for%20a%20Directive%20on%20Financial%20Collateral%20Arrangements%20(COM(2001)%20168).pdf
Erp, 'Deconstruction'	Sjef van Erp, 'Deconstruction and Reconstruction of European Property Law: A Research Agenda' in Eleanor Cashin-Ritaine (ed), *Legal engineering and comparative law/L'ingénierie juridique et le droit comparé. Rapports du colloque du 25e anniversaire de l'Institut Suisse de Droit Comparé du 29 août 2008 à Lausanne* (Schultess 2009)
Erp, *Osmosis or Antagonism*	Sjef van Erp, *European and National Property Law: Osmosis or Growing Antagonism* (Walter van Gerven Lectures (6), Europa Law Publishing 2006)
GMRA	Global Master Repurchase Agreement (2011 version)
GMSLA	Global Master Securities Lending Agreement (2010 version)
Gullifer, *Goode and Gullifer*	Louise Gullifer (ed), *Goode and Gullifer on Legal Problems of Credit and Security* (6th edn, Sweet & Maxwell Ltd 2017)
Gretton, 'Financial Collateral'	George Gretton, 'Financial Collateral and the Fundamentals of Secured Transactions' (2006) 10 Edin LR 209
Gullifer, 'Financial Collateral'	Louise Gullifer, 'What Should We Do About Financial Collateral' (2012) 65 CLR 377.
Husa, 'Back to Basics'	Jaakko Husa, 'Metamorphosis of Functionalism – or Back to Basics' (2011) 18 Maastricht Journal of European and Comparative Law 548
Husa, 'Much Ado'	Jaakko Husa, 'Functional Method in Comparative Law – Much Ado About Nothing' (2013) 2 European Property Law Journal 4
Luhmann, *Social System*	Niklas Luhmann, *Law as a Social System* (Klaus Ziegert, tr, Oxford University Press 2004)

Luhmann, *Soziologische Aufklärung*	Niklas Luhmann, *Soziologische Aufklärung 1: Aufsätze Zur Theorie Sozialer Systeme* (Opladen: Westdeutscher Verlag 1991)
Penner, 'Beneficial Property'	James Penner, 'The (True) Nature of a Beneficiary Equitable Proprietary Interest under a Trust' (2014) 27 Can J.L & Jurisprudence 473
Penner, 'Bundle of Right'	James Penner, 'The Bundle of Right Picture of Property' (1996) 43 UCLA L Rev 711
Penner, *The Idea of Property*	James Penner, *The Idea of Property in Law* (Oxford University Press 2000)
Rahmatian, '*Copyright and Creativity'*	Andreas Rahmatian, *Copyright and Creativity: The Making of Property Rights in Creative Works* (Edward Elgar 2011)
Rahmatian 'German and English Law'	Andreas Rahmatian, 'A Comparison of German Movable Property Law and English Personal Property Law' (2008) 3 Journal of Comparative Law 197
Rahmatian, 'IP and Dematerialised Property'	Andreas Rahmatian, 'Intellectual Property and the Concept of Dematerialised Property' in Susan Bright (ed), *Modern Studies in Property Law*, vol 6 (Hart Publishing 2011) 365
Rahmatian, 'Debt'	Andreas Rahmatian, 'Money as a Legally Enforceable Debt' (2018) 29 European Business Law Review 205
Rahmatian, 'The Political Purpose'	Andreas Rahmatian, 'The Political Purpose of the "Mixed Legal System" Conception in the Law of Scotland' (2017) 24 Maastricht Journal of European and Comparative Law 843
UNIDROIT 'Legislative Guide'	UNIDROIT, Legislative Guide on Intermediated Securities, Implementing the Principles and Rules of Geneva Securities Convention

1 CHAPTER ONE: INTRODUCTION

The thesis is concerned with the functional method and its assumption that legal institutions can be defined in a system-neutral way. The functional method presumes, among other things, that legal institutions can be defined in terms of how they respond to problems, and that based on that we can identify a system-neutral meaning which cuts across different doctrinal contexts.[1]

The thesis takes EU directives as a reference to test this functional assumption of system-neutrality. Although it has been presupposed by some authors that directives adopt a functional method,[2] the thesis demonstrates how this is so. The argument is that directives are drafted in the presumption that implementing laws of Member States are functionally equivalent. This implies that implementing laws give rise to the same effects and are presumed to provide functionally equivalent solutions to specific legal issues. At the level of directives, the idea of functional equivalence makes it possible to identify common features, or a system-neutral meaning, of legal institutions and concepts which are contained in directives.

The thesis uses the Financial Collateral Arrangement Directive to test this assumption of system-neutrality.[3] In this light, it is considered whether legal concepts and ideas contained in the Directive are system-neutral. These concepts and ideas are presupposed in the definitions of a 'title transfer financial collateral arrangements' (TTFCA) and a 'security financial collateral arrangements' (SFCA). Their definitions are provided below because of their central importance to the questions considered in the thesis.

A TTFCA is defined by the Directive, in Article 2 (1) (b), as:

> [A]n arrangement, including a repurchase agreement, under which a collateral provider transfers full ownership of, or full entitlement to, financial collateral for the

[1] For a discussion on the functional method, see: Ralf Michaels, 'The Functional Method of Comparative Law' in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (OUP 2006) 370; Michele Graziadei, 'The Functional Heritage' in Pierre Legrand and Roderick Munday (eds), *Comparative Legal Studies: Traditions and Transition* (Cambridge University Press 2003) 100; Jaakko Husa, 'Functional Method in Comparative Law – Much Ado About Nothing' (2013) 2 European Property Law Journal 4; Jaakko Husa, 'Metamorphosis of Functionalism – or Back to Basics' (2011) 18 Maastricht Journal of European and Comparative Law 548; Julie De Coninck, 'The Functional Method of Comparative Law: Quo Vadis?' (2010) 74 Rabels Zeitschrift für ausländisches und internationales Privatrecht 318.

[2] Graziadei (n 1) 113; Michaels (n 1) 377.

[3] Council Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements [2002] OJ L168/43. This was amended by Directive 2009/44/ EC amending Directive 98/26/EC on Settlement Finality in payment in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims [2009] OJ L146/37. They will both be referred to as the 'Collateral Directive'.

> purpose of securing or otherwise covering the performance of relevant financial obligations.

Article 2(1) (c) further defines an SFCA as :

> [A]n arrangement under which the collateral provider provides financial collateral by way of security to or in favour of the collateral taker, and where the full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral provider when the security right is established.

The definition of a TTFCA presupposes the following: first, there is a system-neutral idea of full ownership in Member States (chapter five); secondly, that financial collateral can be the object of ownership (chapter six); and thirdly, that a TTFCA, as an arrangement, can be identified in the Member States in terms of the definition above (chapters seven and eight) . In relation to SFCA, the Directive also presupposes that: we can identify a system-neutral concept of security (chapter nine),as well as the concepts of possession and control (chapter ten) which are used by the Directive in relation to the SFCA.[4] Essentially, the central question considered in the thesis is whether, as presupposed by the Collateral Directive, the concepts and ideas presupposed by the Directive are indeed system-neutral.

1.1 METHODOLOGY

1.1.1 'Social problem' not a term of art

The thesis focuses strictly on doctrinal concepts and institutions. Because of this, an examination of the tenets of the functional method, as done in chapter two, raises a question: that is, how do we define the term 'social problem' as used by the functional method, in relation to the analysis of doctrinal legal concepts?

As will be discussed in chapter two, the core tenet of the functional method is that it defines institutions not directly but as response to 'social problems'.[5] This presupposes that any work or legislative drafting, like the Collateral Directive, needs to be drafted in a way as to focus on 'social problems' rather than on doctrinal legal concepts. As such, instead of focusing on specific legal concepts, such as 'full ownership' or 'by way of security' (which apparently raise doctrinal issues), the emphasis, and drafting of Directives, should be on how these legal concepts provide answers to specific 'social problems'.

[4] The term 'provides' as used in the definition of an SFCA is defined in Article 2(2) as when collateral is in the possession or control of the collateral taker.
[5] Coninck (n 1) 323.

On the one hand, the above suggests that there may be nothing functional about, for example, the idea of 'full ownership' in the Collateral Directive. But, on the other hand, the phrase 'social problem', as demonstrated in section 3.2, is not a term of art. Instead of interpreting that term independently in a way that suggests that any work on legal, doctrinal concepts need to focus on practical situations, the phrase needs to be seen within the broader theoretical framework of the functional method: it does not analyse institutions directly but in a purposive or consequentialist matter. Thus, when it is stated that the functional method does not define institution directly, but on how they respond to 'social problems' or 'legal need'.[6] what is meant by this is that the method does not define institutions within a doctrinal context, but in terms of specific consequences or effects or pragmatic ends. As discussed throughout the thesis and more broadly in section 2.3, this view finds support, for example, in some scholarly works within the law, such as Sjef van Erp's work [7] and Rahmatian's,[8] and even in the UNIDROIT Convention on Substantive Rules for Intermediated Securities which apply the functional method.[9] What is common amongst these is that they do not just focus on doctrinal legal concepts, but describe those concepts in terms of how they operate or their contents or effects.

Regarding the thesis, two points may be made. First, the method adopted in the thesis does not consider practical social problems, for example, the practical social problems which the idea of ownership or security devices in systems seek to solve. The thesis, rather, adopts the same understanding of the functional method as that seen in the works of Sjef van Erp and Rahmatian, and in the UNIDROIT Convention. This presupposes, as will further be argued in chapter three, that when it is said that EU directives, and the Collateral Directive in particular, adopt a functional method, what is meant is that they presuppose that institutions in Member States are equivalent in terms of their effects or consequences, and thus we can identify a system-neutral meaning based on those equivalent effects. Thus, although the Collateral

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[6] Konrad Zweigert and Hein Kötz, *Introduction to Comparative Law* (3rd rev. ed, Oxford University Press 1998) 44.

[7] Sjef van Erp, 'European Property Law: A Methodology for the Future' in Reiner Schulze and Hans Schulte-Nölke (eds), *European Private Law - Current Status and Perspectives* (Munich: Sellier European Law Publishers 2011) 227–249. Also available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1734633, pp 16-17

[8] See Andreas Rahmatian, 'A Comparison of German Movable Property Law and English Personal Property Law' (2008) 3 Journal of Comparative Law 197, 246 who acknowledges that he adopts a functional method, although he notes that his aim is not to identify a 'common core' idea.

[9] See the UNIDROIT Convention on Substantive Rules for Intermediated Securities, 2009 and the legislative guide: UNIDROIT, *Legislative Guide on Intermediated Securities, Implementing the Principles and Rules of Geneva Securities Convention* (May 2017), p. xxiv (Glossary) , available at : https://www.unidroit.org/instruments/capital-markets/legislative-guide (accessed 20 August 2018) (UNIDROIT Legislative Guide). For example, they define property rights as rights effective against third parties.

Directive uses phrases or legal concepts such as 'full ownership', 'by way of security', 'possession and control', which on their own denote doctrinal concepts, there is the implied presupposition, when these words are used, that their effects are equivalent in Member States. In addition to this, there are other explicit provisions in the Directive which expressly specify particular effects or criteria, which are presupposed to be present in Member States. For example , as discussed in chapter seven, the Directive provides that TTFCAs in all systems arise once: a) ownership is transferred ; and b) for a security purpose. In relation to an SFCA, it similarly provides that we can identify an SFCA using the two criteria discussed in chapter nine, that is, the provision 'by way of security' and ownership retention. Essentially, the presupposition behind directives is that these express criteria can be used to functionally identify equivalent institutions in all Member States.

1.1.2 Civil law/Common Law as opposed to Member States

The thesis is about comparative law methodology. Because of the nature of questions to be considered, a comparative law approach is taken.

As noted, the thesis focuses on EU directives which generally take effect when implemented by Member States. The implication of this is that the focus of the thesis therefore ought to be on the individual legal systems in the EU to identify how the implementing laws match with the provisions of the Directive. However, this is broadly not the approach adopted in the thesis. The focus in the thesis is only the UK implementing legislation, from the English and Scots law perspectives. Scots property law,[10] which is Civilian in nature, is compared with the wider Civil law systems, especially aspects of Dutch law and German Law, without really focusing on the specific implementing legislation in these systems. The reason for this is because of a limitation to access legal materials on these systems.

[10]Although Scots law has a 'mixed' legal system, its property law is civilian. Andreas Rahmatian, 'The Political Purpose of the "Mixed Legal System" Conception in the Law of Scotland' (2017) 24 Maastricht Journal of European and Comparative Law 843, 844-849. Rahmatian rightly suggests that there are possible flaws in describing the Scottish Legal system as mixed. He argues that the idea of a mixed legal system is often used in a reductionist way in different senses a) as a 'simple mix' of common law and civil law; or b) a mixture of private law and commercially related private law, not including Scots criminal law or public law. He notes that this suggests that only aspects of this system are mixed and thus it is inaccurate to categorize such systems as a whole as 'mixed', although as suggested by Rahmatian, describing the system as 'mixed' serves a political purpose to maintain the independence and uniqueness of Scots law. *Contra* Rahmatian, it may be said that Scots law is a 'mixed' legal system to the extent that specific aspects of its laws, i.e. property and even contract, have been substantially influenced by English law and Civil law. It is this different aspects, or particular branches of law, existing collectively —but from different sources— that make up the Scottish (mixed) Legal System.

However, it is important to note that within Civil law national systems, there may be discrepancies in terms of the approach to some of the issues dealt with in the thesis. For example, as discussed in chapter five, although Scots law recognises the idea of absolute ownership, there is a controversy in Scots law whether a remedy of vindication is recognised. Also, as mentioned in chapter seven, Civil law systems give different responses to the *fiducia cum creditore*: while some prohibit the transaction, others impose registration requirements on it. Regardless of these, there are substantial similarities in terms of the shape of the legal concepts, as seen in the discussion on ownership and the *fiducia cum creditore* which is substantially similar in Scots and Dutch law.

It is also important to note that the thesis generally adopts a sceptical position. Therefore, the chapters do not, in some cases, consider the issues equally from Civil and Common law. Rather, it considers the issues based on the areas where there are controversies. For example, chapter five, which considers whether we can identify a concept of ownership in all systems, focuses more critically on English law where, unlike in Civil law systems, there are controversies as to whether English law has a concept of ownership. Also, chapter ten on possession and control considers the issue from the English law angle, where there are controversies as to the meaning of possession and control.

1.1.3 Doctrinal principles as opposed to function

In addition to the comparative methodology adopted, the thesis is also, principally, a doctrinal work. This may be criticised as already providing an answer to the questions posed above, since the functional method, as seen in chapter two, is anti-doctrinal. However, this criticism may not matter much, since the functional method presumes that doctrinal context may be reconstructed into specific effects. Thus, the key question in the thesis is whether this is possible, and this requires we consider these institutions in their doctrinal context to demonstrate if they can be seen simply in the light of specific effects.

In adopting a doctrinal approach, the most important sources are the Collateral Directive, case law and academic works. The focus on TTFCA and SFCA implies that the primary research area is the property law aspects of finance law.

1.2 AIMS OF THE FINANCIAL COLLATERAL ARRANGEMENT DIRECTIVE

As earlier mentioned, the thesis tests the assumption of system-neutrality using the Collateral Directive, which is one of the few EU Directives on property law. The Collateral Directive was introduced for the purpose of removing legal impediments for the achievement

of a single market in the EU.[11] First, the rules for taking and enforcement of collateral varied among Member States. This led to uncertainties in transactions which had a cross-border element, since market participants had to deal with unfamiliar laws in different systems. Secondly, there were rules in some systems, which made it difficult to take or enforce collateral. In some cases, rules in legal systems prohibited parties from taking certain desired actions. For example, most systems prohibit secured creditors from dealing with the secured collateral. Thirdly, there were also different rules in systems as to the proper approach to be adopted to certain transactions (i.e. a TTFCA) under which ownership was transferred for a security purpose. As discussed in chapters four and seven, because these transactions performed a security function, some systems recharacterised the transaction as a security right with the effect that it was treated as void or unenforceable against third parties. However, some other systems recognised the transaction as a transfer with the effect that it took effect as it is.

The Collateral Directive was therefore formulated to bring about a harmonised framework across these different systems. To achieve this purpose, the Directive disapplies those rules in Member States which hindered collateral arrangements: first, it disapplied the formal requirements for the creation of collateral arrangements. These rules, as highlighted in chapter eight, include the rules on publicity such as registration.[12] Also, it disapplied rules on the enforcement of collateral which prohibited a collateral taker from appropriating the collateral in the event of default. The aim of this was to allow for a less formalistic approach in realising collateral;[13] thirdly it disapplied rules which prohibited a collateral taker from using the collateral under a security device. Those rules were thought to impede liquidity in the market.[14] It also disapplied rules invalidating or placing some restrictions on a TTFCA in Member states. To this effect, the Directive required Member States to recognise the arrangement as it is, i.e. as a transfer of ownership for a security purpose.[15] Lastly, it required Member States to give effect to close-out netting clauses in a collateral arrangement in insolvency.[16]

[11] Louise Gullifer, 'What Should We Do About Financial Collateral' (2012) 65 CLR 377, 384.
[12] Collateral Directive, art 3.
[13] Collateral Directive, art 4.
[14] Collateral Directive, art 5.
[15] Collateral Directive, art. 6.
[16] Collateral Directive, art 7. A close-out netting provision is defined as a provision whereby the obligations of the parties are accelerated or terminated so as to be immediately due as an obligation to pay an amount representing their estimated current value. An account will normally be taken of what is due from the parties to each other and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party. See Article 2 (1) (n).

However, for a transaction to enjoy these benefits, it must be either a TTFCA or an SFCA as defined above. As mentioned earlier, these definitions raise certain questions which the thesis consider.

1.3 ARGUMENTS BY CHAPTER

Chapters five - ten consider whether the concepts and ideas presupposed in the definition of a TTFCA and SFCA are system-neutral. In considering the above issues, chapter two, as a prelude, reflects on the historical origin of the functional method, its assumptions and the criticism against the method. It is highlighted that the method arose as a reaction to the doctrinal study of institutions, and sought to provide an objective approach not tainted by the internal perspective of the comparatists. Thus, it takes an outsider perspective to reconstruct context into specific effects. To achieve this purpose, it presumes that: first, the function, or effect, of institution is the key focus; secondly, that systems encounter similar problems and provide functionally equivalent solutions , though doctrinally different, to those problems; and thirdly that function or effects can somewhat be removed from their doctrinal context. The first assumption is criticised for not providing any objective criteria for identifying function; the second is criticised for showing a bias towards similarity, while the third is criticised on the ground that the functional method is too rule-centered and does not consider doctrinal context which should always matter.

Chapter three explores how EU directives adopt a functional method. It will be argued that directives generally are anti-doctrinal, since they are binding as to the results to be achieved. Secondly, the implementing laws are deemed to be functionally equivalent, which presupposes that they have the same effect. Based on this assumption, it is presumed that because the effects are equivalent, it is possible to identify a common, system-neutral meaning which may be identified in the various systems.

Chapter four considers the aim behind the provisions on the TTFCA, which as noted above, is to prevent Member States from recharacterising the transaction as a security device. Because questions about what amounts to a TTFCA often raise issues about what a security right is (i.e. SFCA), the discussion in chapter four feeds into the chapters on TTFCA and SFCA. It is highlighted that in characterising a transaction, systems may adopt either a formal or functional approach.[17] The former considers the legal consequences which the parties intend

[17] The 'functional approach' should not be confused with the functional method of comparative law. The functional approach, as discussed in chapter four, deals with the characterisation of property transactions.

to bring about, while the latter considers the economic motive behind the transaction to secure an obligation. It will be highlighted that when a transaction is recharacterised, several consequences may arise: the transaction may be declared as a security right and declared unenforceable against third parties or it may be pronounced void. The argument will be made that in mandating Member States to legitimise a TTFCA, the Directive adopts a formal approach: thus, the presumption is that the parties intended to bring about the consequences under the arrangement, regardless of the security purpose behind the transaction.

Having set the context, chapters five – ten set out to identify if a system-neutral meaning of the concepts presupposed by the definitions of a TTFCA and an SFCA above can be identified.

Chapter five demonstrates that although we can identify a concept of full ownership in Civil law, the same cannot be said in relation to English law. Although it is normal to see reference to the idea of ownership in English law, in line with Honoré's definition examined in chapter five,[18] that idea doctrinally does not refer to a specific concept denoting a right vested on a single person but to a bundle of rights. It was argued that the idea of ownership may not be present in English law because of the relative nature of property rights, seen most especially in the case of a trust where property right is fragmented between the trustee and beneficiary. Regarding the beneficiary's interest, the point was made that it is not an ownership interest since it is conceptually a negative right of non-interference which does not include the positive side. Nonetheless, even if the argument can be made that it is a right *in rem* because it has third-party effects, this does not indicate that it is an ownership right, since a limited real right, which arises in an SFCA, is also a right *in rem* but not an ownership right. Furthermore, even if it can be said that, from a functionalist perspective, the beneficiary enjoys some positive powers to access the assets, since it is held for his benefit, those positive powers are limited in scope and conceptually operate as a right in the right of another (trustee). In essence, they do not provide enough access to the property to lead to the conclusion that there is an ownership right in the sense of Civil law ownership. Thus, the rights and powers of the beneficiary, although functionally similar to Civil law ownership, are not consistent enough to make a finding that beneficial interest is full ownership. Moreover, even if we are to identify ownership in English law based on the particular rights of an owner, only a common law title holder may qualify as such, since he is said to have the powers and rights of an owner. As argued, this

[18] Tony Honoré, 'Ownership' in Anthony Gordon Guest (ed), *Oxford Essays in Jurisprudence* (OUP 1961) 107–147.

position is consistent with some views which give priority to common law title on the basis that possession is indivisible.[19] If the trustee has the title to exclusive possession, the beneficiary cannot be vested with the same right. The indivisibility of possession makes it impossible to conceive of a separate right to the same asset. However, as argued, this has implication for the Collateral Directive, as it implies that beneficial interest is not full ownership.

Chapter six considers whether the idea of ownership of collateral (i.e. claims) is a system-neutral idea. This issue will seem settled: it is normal to hold that because financial collateral is important in the financial markets, that it is self-evident that it is a valid object of ownership. On the contrary, the chapter demonstrates that this is not self-evident, as they are contrasting approaches to this issue all of which are equally valid. On the one hand, there is an approach which restricts ownership to tangible things, although it acknowledges that a person can be 'entitled' to rights (i.e. financial collateral). The second approach broadly endorses the view that both tangible things and intangibles, like financial collateral, can be valid objects of ownership. In examining these two approaches, it was demonstrated that they are equally valid if it is accepted that they define property rights differently, in terms of the attention they pay to the property/obligation boundary. On the one hand, the direct implication of the first approach is that if claims, such as collateral, give rise to personal rights for any reason, they can only be personal rights for all reasons, since ownership, from the outset, is defined as a right in a corporeal thing. An indirect effect of this is that the objects of ownership, contrary to a widely held view, cannot be defined based simply on the concepts of transferability, or that claims can, in some instances, be vindicated against third parties, or on the internal contents of the rights of owner. As a corollary to this argument, it was demonstrated that the second approach pays less attention to the property/obligation boundary. This is evident from the fact, among others, that they tend to distinguish a property right from a personal right in terms of who the rights are exigible against. In this regard, the argument was made that one implication of this approach is that it represents property rights as particular manifestations of personal rights.[20] This is so regardless of whether there is a claim-*res* over which such real rights are held: the burden of the right follows a person, not a thing. Although this approach blurs the distinction between property and obligation, this is not a problem if it is acknowledged that systems which adopt this have a different conceptual understanding of a real right. Essentially, what this suggests is that the particular objects which can validly be objects of ownership are system-dependent. It was further argued that although the Directive uses the concepts of entitlement and

[19] Although choses in action cannot be possessed, it seems likely that at the level of allocating importance to property rights, the concept of possession had an impact on how beneficial ownership is conceived.

[20] Andreas Rahmatian, 'Intellectual Property and the Concept of Dematerialised Property' in Susan Bright (ed), *Modern Studies in Property Law*, vol 6 (Hart Publishing 2011) 365.

ownership as if they are equivalent or give rise to the same effects, this is not so. For example, particularly in relation to the right of disposal (*abusus)* of a property object, the creditor of a personal right (i.e. financial collateral), compared to an owner of a tangible thing, cannot dispose of the right in the same way as an owner. The underlying basis for this, it was argued, is because the internal structure of the right is a personal right.

Chapters seven and eight consider whether we can identify a system-neutral meaning of a TTFCA. Chapter seven begins by identifying the conditions of applicability which must be satisfied before an arrangement can qualify as a TTFCA in the Directive. As earlier mentioned, these conditions of applicability are examples where the Directive explicitly sets out specific criteria which it deems present in every system. In this regard, it was argued that for a transaction to be a TTFCA, two conditions of applicability must be met: a) there must be a transfer of ownership and b) for a security purpose. In relation to Civil law , it was demonstrated, in chapter seven, that the relevant institution is a *fiducia cum creditore*. Although some systems, such as Dutch law before 1992, characterise such an arrangement as a security device, rather than as a transfer, the argument was made that even within the context of the pre-1992 Dutch law position, the Dutch law *fiducia cum creditore* still comes within the scope of the Directive based on the two conditions of applicability.

Chapter eight applies those conditions of applicability to English law to demonstrate how a legal mortgage appropriately satisfies those two conditions of applicability and hence can be described as a TTFCA under the Directive. However, it was argued that this effect is not an outcome desired by the Directive, since this implies that English law will have to recognise a legal mortgage as a TTFCA, rather than as an SFCA (security device). However, the chapter demonstrates that contrary to the functional definition of an TTFCA in the Directive, a legal mortgage is not a TTFCA. This outcome is dependent on the interpretation to be given to the equity of redemption within the doctrinal context of English law. Therefore, a legal mortgage will only fall outside the scope of the Directive when the equity of redemption is interpreted not as a personal right, but as a residual right. What these suggests is that the functional criteria set by the Directive (i.e. conditions of applicability) are not system-neutral, since although both a legal mortgage and *fiducia cum creditore* have similar effects based on the definition of a TTFCA, we can only understand those effects within the context of the English doctrinal system.

While chapters five – eight focus on the definition of a TTFCA, chapters nine and ten focus on the definition of an SFCA in the Directive and the requirement of possession and control to be met before an arrangement can be an SFCA. In other words, the chapter asks if we can identify a

system-neutral meaning of an SFCA and the concepts of possession and control in the Directive. On the first issue, the chapter identifies two requirements to be jointly satisfied for an arrangement to be an SFCA, i.e. a) that the collateral provider must have provided the collateral by 'way of security' and b) that the collateral provider must retain ownership of the collateral. Similar to the observations in chapter six, these two requirements are another situation where the Directive explicitly provides specific criteria which it presumes are similar in all systems. However, it was argued that, although the Directive presupposes that there is a clear conceptual difference between a transfer (TTFCA) and a security (SFCA), this is not always the case. This is because there are institutions, such as a legal mortgage and the *fiducia cum creditore* in Dutch law before 1992, which are security devices but operate as a transfer. This indicates that what amounts to a security right is system-dependent. Secondly, if security institutions are to be defined by their specific effects, nothing stops us from defining them not just in terms of effects which are similar (indeed there are similarities), but those effects which are doctrinally different. Therefore, their differences indicate that the institutions are system-dependent.

Chapter ten demonstrates that the concepts of possession and control are system-dependent: first, the interpretation given to the possession and control requirement by the courts, most especially by the Court of Justice of the European Union in *Private Equity Insurance Group SIA v Swedbank AS*,[21] aligns strongly with the English law idea of control which is based on the fixed/floating charge distinction. This is re-echoed by the fact that the possession and control requirements in the Directive perform the same function as the control requirement under English law. However, it was argued that although there are situations, especially where a collateral provider has a right of substitution and withdrawal, where it seems that the control requirements in English law is different from the control requirements in the Directive, those particular situations are only consequences of applicability which the Directive deems to arise only once a collateral taker is in possession or control. This explains the reason why a floating charge will in most cases not fall within the scope of the Directive while a fixed charge does so. This is because the control requirements apply to both. The conclusion which was drawn from this was that the control requirements in the Directive mirror that under English law.

Chapter eleven brings together the arguments and considers their implications for the functional method. Two conclusions were drawn: first, although we can identify some functional similarities between institutions, it is not possible to normatively define institutions in a functional

[21] *Private Equity Insurance Group SIA v Swedbank AS* (2016) 1 BCLC 207.

way in terms of specific effects. This is because this falsely represents such institutions as existing simply in terms of those specific consequences without any underlying doctrinal principles or historical existence. The second conclusion, which is related to the first, is that because institutions can only be defined within a system of doctrinal principles, a functionalist cannot, as the Directive presupposes, take a constructivist approach. Adopting such an approach raises methodological questions regarding the criteria to be used in identifying the particular consequences or effects which are to be used to normatively define such an institution: for example, as seen with beneficial ownership, what quality of a real right can be used to define it? Do we use its insolvency protection function or the fact that it has third party effects? Does insolvency, by itself, suggest an ownership right across the systems? Can we define real rights simply in terms of third-party effect? What informs the decision to define it, as presupposed by the Directive, in terms of 'full ownership? Similar questions also arise in relation to the other issues considered in the thesis. Importantly, the reason why questions of this sort arise in relation to the criteria to be adopted in defining legal institutions is because the functional method reconstructs doctrinal context into particular effects. It denies that there are any inherent purposes guiding how institutions operate. Thus, a constructivist approach is necessarily subjective, denying any inherent purpose to such an institution.

1.3.1 STRUCTURE

The work is divided into three parts. The first is the general part and consists of chapters two-four. As already highlighted, these chapters provide the context for the issues considered in the remaining part of the thesis. The second part consists of chapters five – ten which examine the specific question regarding the system-neutrality of the concepts. The third part consists of chapter eleven which is the conclusion. It restates some of the criticisms made against the functional method in chapter two.

PART A

2 CHAPTER TWO: THE FUNCTIONAL METHOD AND ITS ASSUMPTIONS

2.1 INTRODUCTION

As a prelude to the next chapter, where the argument is made that EU directives adopt a functional method, this chapter considers the functional method and its assumptions. The aim is to identify the core assumptions of the functional method, which then enables us to draw the link between the functional method and the methodology behind how EU directives operate (in the next chapter).

In this light three key assumptions will be discussed below:[22] first, that the function of a legal institution ought to be the key focus of comparative law; secondly, that every legal system encounters similar social problems and provides similar solutions, though doctrinally different, to those problems; and thirdly, that legal institutions can be defined in a system-neutral manner outside their doctrinal context.

As discussed below there are controversies surrounding these assumptions of the functional method.[23] As a result of these controversies, the functional method is said to represent 'everything bad about comparative law'.[24] As a theory and practice, the method is said to be a 'chimera'[25] and 'hardly exist[s]' in any elaborated form.[26] On the other hand, there have been attempts to save the method from criticism. First, it is argued that the method is merely a 'rule of thumb' which equips the comparatist with certain epistemic assumptions.[27] It is also argued that it is a pragmatic method which helps the functionalist to arrive at results which are respected.[28]

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[22] The assumptions discussed in this chapter are not considered in a systematic way in most of the texts on the issue. For example, see Zweigert and Kötz (n 6) 32–52; Graziadei (n 1) 100–127; Husa, 'Much Ado' (n 1) 4–21; Michaels (n 1) 340–382. The chapter identifies the key principles of the method and then discusses them under the headings of the assumptions identified in the chapter.

[23] For a critical perspective on the method, see: Michaels (n 1) 340–382; Husa, 'Functional Method in Comparative Law – Much Ado About Nothing' (n 1); Husa, 'Metamorphosis of Functionalism – or Back to Basics' (n 1) 548; Günter Frankenberg, 'Critical Comparisons: Rethinking Comparative Law' (1985) 26 Harvard International Law Journal 41; Graziadei (n 1) 109.

[24] Michaels (n 1) 340.

[25] ibid.

[26] ibid.

[27] Such as the awareness that the functionalist is about analysing a different system. Husa, 'Much Ado' (n 1) 17.

[28] James Gordley, 'The Functional Method'' in Pier Monateri (ed), *Methods of Comparative Law* (Edward Elgar 2012) 107.

Drawing from the three assumptions discussed in this chapter, the argument here re-asserts the last point above that the functional method is indeed a pragmatic method. It is pragmatic because it is focused on the achievement of results, and this saves it from some of the criticisms, for example, that it under-theorised or not elaborate enough. Besides, the proponents of the method, as they admitted, never intended to provide a 'logical or self-contained methodology'.[29] However, while this pragmatism highlights the positive sides of the method to achieve results, it leaves many unanswered questions, exposing the method to controversies. In some sense, it is these controversies arising from the assumptions mentioned above, especially that in relation to system-neutral definition of legal institutions, that is considered in chapters five – ten of the thesis. Thus, the discussions especially in the second part of the thesis considers that aspect of the controversy.

The chapter therefore sets out the three assumptions of the functional method and the criticisms surrounding these assumptions. However, before proceeding with this, we will consider the historical background of the method. This provides some context for the rationale behind the three assumptions discussed later, since the assumptions are analytical devices in response to the doctrinal study of law which presupposes that law can only be seen within a doctrinal context.

2.2 THE FUNCTIONAL METHOD: A RESPONSE TO THE CONCEPTUAL STUDY OF LEGAL INSTITUTIONS

The functional method arose in response to the historical study of law.[30] In the 19th century, the study of law was focused on contextual aspects along the lines of Savigny's historical school of jurisprudence and the Pandectists conceptual study. It is said that these approaches had a 'repressive effect on the development of comparative law'[31] making it difficult for it to flourish. The prevalence of the doctrinal study of law may be attributed to the fact that lawyers only had to deal with domestic law issues. This reinforced the drive towards a contextual study of concepts. As an alternative to this approach, Feuerbach canvassed for a method which ought to be global in its outlook. He argued that in the same way that anatomists have comparative anatomy, it should also be possible for jurists to have comparative law.[32] It

[29] Zweigert and Kötz (n 6) 33.
[30] ibid 50.
[31] ibid. This may be because comparative law is universal in its outlook unlike the historical school which focused on the national doctrinal principles.
[32] Anselm von Feuerbach, '*Blick auf die Teutsche Rechtswissenschaft'* in Feuerbach (ed), *Kleine Schriften vermischten Inhalts* (1833) 152,162 cited in Zweigert and Kötz (n 21) 53.

was his view that there is no more productive source of discoveries than those derived from a comparison of a foreign system.

Comparative law witnessed a slow growth in the 19th century, although it was still influenced by the historical study of law which was formalistic, focusing basically on the 'taxonomic and analytical description of technical application of one or more systems'.[33] The reemergence of the comparative method in the early 20th century is linked to the Paris Congress in 1900 which is noted to be the 'starting point of methodological and scientific comparative law'.[34] The main objective at the Congress was to spell out a system of comparative law,[35] and to prompt a search for a methodology, along the lines of other works which similarly sought to address the methodological gap in both the teaching of comparative law and its study.[36]

The functional method was introduced into comparative law at the beginning of the 20th century through the work of Ernest Rabel [37] who was concerned with recharacterisation problems in conflict of laws.[38] Rabel thought that problems of recharacterisation could be solved by looking past the phraseology of conflict rules in order to identify the facts of life which are similar in all systems. He noted that comparatists should study legal institutions, and that instead of concentrating on the study of materials and isolated provisions, the functionalist should study the 'social purpose of rules and the service of the concepts to this purpose'.[39] Rabel was inspired by the similarities in the problems amongst different systems and the identical approaches and solutions adopted through law.[40] It was claimed that a focus on the social purpose and function of a legal institution gives rise to a 'clearer conception of the province of comparative law'.[41]

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[33] Max Rheinstein, 'Teaching Comparative Law'' (1937) 5 University of Chicago Law Review 615, 617.
[34] Esin Örücü, *The Enigma of Comparative Law: Variations of a Theme for the Twenty-First Century* (1st edn, Springer 2004) 20.
[35] Zweigert and Kötz (n 6) 59.
[36] See Rheinstein (n 33) 315–318, who notes that comparative law in schools, at the beginning of the 20th century, had 'no clear conception' but vaguely referred to juristic activity focused on one or more systems. To him this amounted to a 'haphazard' study of law and could not properly be qualified as a comparative study but merely a 'monographic and synoptic' observation of law. He said comparative law must be 'functional' to be an effective discipline. See also Ernst Rabel, *The Conflict of Law: A Comparative Study*, vols 1–3 (2nd edn, 1945).
[37] Zweigert and Kötz note that the functional method which is preached today 'comes from the research which Rabel evolved and perfected'. Zweigert and Kötz (n 6) 61.
[38] Graziadei (n 1) 104. See also Husa, 'Much Ado' (n 1) 10.
[39] Ernst Rabel, *Aufgabe und notwendigkeit der rechtsvergleichung* (München : M Hueber 1925) 4.
[40] Husa, 'Back to Basics' (n 1) 548,550.
[41] Rheinstein (n 33) 615.

This principle was restated by Zweigert and Kötz who claimed that the question to which any comparative study should be focused must be posed in 'functional terms and that the problems must be stated without any reference to the concept of one's own legal system'.[42] This idea, as Michaels notes, was driven by the ideals of 'universalist humanism' and 'legal unification'.[43] It sought to give a methodological bent to the study of comparative law. Therefore, instead of focusing on the contextual study of law, the method focuses on the functions of law and how it reacts to legal needs.

There is a long tradition of functional explanation in studying society within the sociological schools. These schools inspired the thinking in functionalist comparative law.[44] For example, in sociology, a functional explanation accounts for the existence of a phenomenon in terms of its consequences to maintaining a stable social system. This formulation corresponds with the principles under functionalist comparative law which defines functionalism in terms of the legal outcome in relation to legal needs. What drives this idea in sociological functionalism is that social systems are seen conceptually as organic.[45] This idea is seen particularly among proponents of the Systems Theory which explain society as an organic whole, with each of its constituent parts, including law, working to maintain the other parts.[46] For systems theory, law is seen as an 'autopoietic' subsystem,[47] differentiated from the other parts and carrying out the primary function of self-reproduction of the social system.[48] This formulation allows law to be separated from the social system with the capacity to evolve into a new system.

The above suggests that the functional method owes some of its ideas to other disciplines.[49] Michaels, for instance, identifies seven concepts of functionalism all of which he

[42] Zweigert and Kötz (n 6) 34.
[43] Michaels (n 1) 362.
[44] Mainly seen in sociology. Emile Durkheim is seen as 'one of the most important progenitors' of functionalist thinking in sociology. See .See Whitney Pope, 'Durkheim as a Functionalist' (1975) 16 Sociological Quarterly 361–379. He is said to have inspired other influential functionalists such as Kingsley Davis, Robert Merton and Talcott Parsons. For example, see Kingsley Davis, 'The Myth of Functional Analysis as a Special Method in Sociology and Anthropology' (1959) 24 American Sociological Review 757–772; Talcott Parsons, 'The Present Status of "Structural-Functional Theory in Sociology"' in Talcott Parsons (ed), *Social Systems and the Evolution of Actions* (New York: Free Press 1977) 100–117.
[45] Husa, 'Back to Basics' (n 1) 548.
[46] See Niklas Luhmann, *Law as a Social System* (Klaus Ziegert, tr, Oxford University Press 2004) 467; Niklas Luhmann, 'Law as a Social System' (1989) 83 Northwestern University Law Review 136, 137.
[47] Luhmann, *Social System* (n 46) 465.
[48] Luhmann, 'Law as a Social System' (n 46) 137.
[49] Michaels (n 1) 362.

argues are implicit within functional comparative law. He identifies a)'finalism' which defines the purpose of things or their *telos* as intrinsic to their nature:[50] b)'adaptionism', a Darwinian idea which sees society as a complex organism evolving as a whole while its elements perform some function in its evolution:[51] c) 'classical functionalism' which considers an institution's existence as being related to its function but without the teleology in finalism. Thus this arose primarily as a drive to make sociological study value-free, by ridding it of the teleological bias;[52] d) 'instrumentalism', a normative theory using law as a tool for social engineering;[53] e)'refined functionalism' which emerged as a critique of earlier functionalist approach in sociology by, among others, differentiating latent functions which earlier went unrecognized from manifest functions, and also identifying non-functional or dysfunctional institutions;[54] f) epistemological functionalism, a Kantian concept which attempts 'a seismic shift from a focus on substance to a focus on function, from attempts to understand how things 'really' are (their substance, ontology) to understanding them only in their (functional) relation to particular viewpoints (their function, epistemology)';[55]g) equivalence functionalism: which considers solutions in different societies as functionally equivalent, although the institutions may be different. [56]

Michaels concludes functional comparative law uses these different concepts but is largely oblivious to their incompatibilities, leading to a mismatch and a concept without any 'recognizable method'.[57] For instance, he argues that although the similarities between legal systems indicate the existence of universal values which suggests an 'Aristotelian background', on the contrary functionalists also place themselves 'outside legal philosophy and within legal sociology'[58] by emphasizing the objective needs of society over values. He further claims that although functionalists sometimes use function in a 'teleological fashion' (more akin to

[50] This is an Aristotelian concept that different laws are responses to the same universal problems. Inherent in this idea is a teleology that correct laws are deduced from the nature of things. Michaels argues that this thinking is seen in functionalist comparatist law which considers systems as having similar solutions to similar problems.
[51] Functional comparative law considers law as adapting to social needs.
[52] Defining institutions in a teleological way means they have an inherent function which makes objective analysis impossible.Michaels (n 1) 350.
[53] See, ibid 351. Zweigert and Kötz note that law is to be used as a tool for social engineering.
[54] ibid 352.According to Michaels, there was an earlier assumption in sociological functionalism that every element in the society performed some function.
[55]ibid 355.Earlier sociological functionalist approach could not explain the nature of function without some implicit assumptions of causality or teleology.
[56] ibid 351, 357.
[57] ibid 352.
[58] ibid 360.

adaptionism), at other times they focus on function and legal institutions as tools for preservation of stability, something related to classical functionalism.

Michaels may be accurate that functionalism combines these disparate concepts. But there is a question whether that itself matters to the proponents of the method who themselves never set out to frame a systematic method. They instead advise the functionalist to use 'sound judgment, common sense and intuition' in any comparative exercise.[59] This suggests that the method may not be possibly concerned with how the different concepts, identified by Michaels, fit together.

Regardless of the foregoing, an argument may likewise be made that the functional method, as Michaels admits, is 'eclectic', adopting principles from different concepts, because of its pragmatism.[60] As such, what results from the mixture of concepts is not a mismatch, but rather a single approach using different conceptual tools to achieve a result. For example, while finalism allows the functionalist to define the nature of legal institutions in terms of their function, epistemological functionalism allows the functionalist to shift his view from the substance (or 'doctrinal underpinnings') of a legal institution to its purpose. A focus on function allows the comparatist to identify which institution performs the function better. In this regard, the 'instrumentalist' thinking allows the comparatist to proffer solutions to social problems. However, in arriving at this particular outcome, the functionalist is required to examine institutions which perform equivalent functions in a foreign system. Equivalence functionalism, which considers the similarity between institutions of different societies aids towards the achievement of this purpose. The functionalist examination is made complete where the legal institution is replicated in his own system: the conceptual tool utilized here is by conceptualizing law as part of a social system with an organic character capable of evolving ('adaptionism'). What therefore results from a combination of these different concepts is not a mismatch – although it may be admitted that underlying nuances may exist — but a combination of different concepts towards the formulation of a functionalist comparatist methodology.

As suggested, the mixture of different concepts above may also be justified on the ground that functionalist comparative law is inherently pragmatic. Since it is pragmatic, the method is not based on a grand theoretical supposition. Rather, it is focused on practical results and how to achieve those results. Michaels notes that in proposing the method, Rabel was

[59] Zweigert and Kötz (n 6) 33.
[60] Michaels (n 1) 362.

interested more in practical problems rather than on an expansive methodology. Husa similarly rejects it as a 'method' but rather considers it merely as a 'rule of thumb' which equips the comparatist with certain epistemic assumptions.[61] These all imply that the comparatists are concerned, most especially, about the achievement of results rather than any systematic coherent theory. Insofar as particular results are achieved, the conceptual tools are less relevant, even if there are contradictions in the way in which those conceptual tools are combined.

2.3 FUNCTIONAL METHOD AND ITS ASSUMPTIONS

As mentioned, Rabel was instrumental to the formulation of the functional method as a methodology. His core thesis was to consider how a social problem is solved in systems, then explore the differences and similarities in the solutions.[62] Zweigert and Kötz, influenced by Rabel, elaborated on his idea. They focused on legal institutions. In their view, the functional method ought to consider legal institutions solely in terms of their functions. According to them, at the start of his inquiry, the functionalist is meant to pose two questions: first, what function does a legal institution serve in its present system, [63] and then secondly, does the institution serve that function adequately? For the functionalists, 'function', or the purpose of legal institutions, defines the usefulness of comparison. It is assumed that incomparables cannot be usefully compared and the only things which can be compared are things which serve the same function.[64]

Zweigert and Kötz maintain that implicit in the search for functionally equivalent institutions is the assumption that all legal systems encounter the same problems and respond to these problems in ways which may be doctrinally different, though very similar functionally. As will be argued in the next chapter, this assumption lies behind EU directives and their implementation. There is the presupposition, within the context of directives, that Member States face similar problems and that implementing legislation in the Member States is functionally equivalent, though doctrinally different.

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[61] Husa, 'Much Ado' (n 1) 17.
[62] ibid 12.
[63] Legal institutions in this thesis refers to 'an elaborate set of patterns for human conduct […] taken to be binding on all persons within the ordered domain […] to the extent that they succeed in matching their conduct to stipulated patterns. Neil MacCormick, *Institutions of Law: An Essay in Legal Theory* (Oxford University Press 2007) 11.
[64] Zweigert and Kötz (n 6) 34; Antonios Platsas, 'The Functional and the Dysfunctional in the Comparative Method of Law: Some Critical Remarks' (2008) 12.3 Electronic Journal of Comparative Law 1, 5 <<http://www.ejcl.org/123/abs123-3.html>> accessed 3 February 2016.< http://www.ejcl.org/123/abs123-3.html> accessed 3 February 2016.

One question from the above is: if problems and solutions are similar, what is the purpose of comparison since the functionalist is expected to find equivalent solutions in all systems after all? One possible response to this is that the comparison is to identify institutions which perform a function better.[65]

Where function is identified, it is to be cut loose from its context. This allows the legal institution to be seen simply in the light of its effect. The presumption behind this is that describing institutions in this purposive way implies that they are not seen within a doctrinal context.[66]

The above discussion highlights three assumptions of the functional method which will be elaborated upon below. However, it is important to note that the major literature on the functional method does not systematically identify and discuss these assumptions as is done in the thesis. [67] What the chapter has done is try to identify the key principles of the method and then discuss them under the headings of the assumptions identified in the chapter.

The three assumptions are: first, that 'function' is the *tertium comparationis* of the functionalist methodology; secondly, that societies experience similar problems and provide similar solutions to those problems; thirdly, that institutions may be removed from their context and seen simply in the light of their purpose? We will consider these in turns.

2.3.1 Function as tertium comparationis

According to the functional method, only legal institutions which fulfil the same function are comparable. On this note, Örücü notes that a functionalist who, for instance, compares an institution called 'divorce' may look at institutions in other systems which perform the function of freeing an individual from a marital relationship. That function serves as the key focus of comparison, which aids in identifying an equivalent institution in another system.[68] It is claimed that focusing on the purpose or effects of an institution allows the functionalists to have a neutral perspective.[69] Based on the functionalist thinking, it may be problematic if the purpose of the rule had been expressed in a conceptual way, for example, to

[65] Geoffrey Samuel, *An Introduction to Comparative Law: Theory and Method* (Hart Publishing 2014) 65.
[66] Zweigert and Kötz (n 6) 34–35.
[67] ibid 32–52; Graziadei (n 1) 100–127; Husa, 'Much Ado' (n 1) 4–21. However, see Coninck (n 1) 318–350 who identifies almost similar assumptions as those in this chapter.
[68] Örücü (n 34) 29.
[69] Coninck (n 1) 327.

enable separations on grounds that a marital relationship has broken down irretrievably. In this sense, the meaning of 'irretrievable breakdown' of marriage becomes a formal requirement which may be defined differently in systems.

Within the context of the thesis, the above raises an issue regarding whether concepts such as 'full ownership', 'possession and control' 'by way of security' are all used by the Directive in the same manner as Örücü's example above. As will be argued in the latter part of this section, although these terms appear to be doctrinal concepts, the presuppositions behind their usage is that there are institutions in the different Member States which have equivalent effects. Besides, interpreting those terms as doctrinal concepts, as will further be argued in the next chapter, defeats how directives are meant to operate.

In making a functional comparison, what is deemed to be similar is neither the legal institutions nor the problems, but the functional connection between the problem and the solution.[70] For e.g., the law on delictual liability and insurance are functionally equivalent because they serve the same function, that is, to provide compensation for accident victims. They are functionally equivalent to the extent that they provide solutions to the same problem.

However, there is a question regarding what criteria can be used to identify function. It may well be argued that the law on delictual liability is to provide compensation to accident victims or to ensure that people exercise due care. Similarly, insurance law may have the function of insuring against diminution in value of an item, or to transfer risk to an insurer. The above suggests that there may not be a fixed criterion for identifying function. As such, the absence of such criteria gives rise to the risk that functions, as ascertained by a functionalist, may be 'closely tied with particularly moral and political principles as to be of no use to anyone' who does not endorse them.[71]

Platsas argues that in identifying the function of a legal institution, no restraint should be placed on the functionalist, so long as the comparison 'bears with certain needs'.[72] Platsas points out that it is the 'purpose of comparison which makes functionality reveal itself', that is, that it is the objective of the comparison that shows the function of a legal institution. He admits

[70] Michaels (n 1) 371.
[71] Joseph Raz, 'On the Functions of Law' in Alfred Simpson (ed), *Oxford Essays in Jurisprudence* (1972) 287 who makes this statement with particular reference to the functions of law within a broader context.
[72] Platsas (n 64) 9.

that although this makes comparison a subjective exercise, since the purpose of comparison is determined by the comparatists, the 'subjective purposes of comparison may well result in subjective tools to pursue such purposes'.[73] To illustrate this point, Platsas gives an example using law reform. He states that assuming a Common law country wants to modernise its old-fashioned intellectual property law as a matter of form rather than substance, because it uses verbose and old-fashioned language, it may refer to the Civil Code of France because of its 'flexible and fresh language'. Platsas argues that in identifying functionality in this scenario, there are two variants: the first is that the country's intellectual property law and the French Civil Code, being substantively different, are not functionally equivalent, because they are different. Therefore, any comparison to that effect will be an 'invalid one'. However, the second variant is to argue that both the country's intellectual property law and the French Civil Code both share the same function as a matter of 'law reform', even if the fact remains that they are different doctrinally. He concludes that it is the purpose or *telos* of comparison (law reform) that shows the function of the legal institution in question.

It may be argued that Platsas' argument mistakes the purpose of comparison and the purpose of the rule compared. The purpose of comparison will normally be determined by the functionalist, while the legal institution will normally have a function different from this purpose. Nonetheless, Platsas argument may make sense if seen within the context of his own suggestion, that legal institutions have no inherent function. If functionality is revealed by the purpose or *telos* of comparison, it is therefore assumed that the legal institution under comparison has no intrinsic purpose, and thus it is possible to conflate the purpose of comparison and the purpose of an institution.

However, the above may be criticised on the basis that function is subjective and not based on any historical existence. Thus, function is seen merely in the light of the objectives to be achieved by the functionalist, rather than on any purpose for which the institution came into existence.

The idea that legal institutions have no purpose is also what makes Platsas refer to the French Civil Code rather than the French Intellectual Property Code, when comparing English intellectual property law. Thus, because institutions have no inherent meaning, it is easy for Platsas to identify function from two disparate institutions which are doctrinally different.

[73] ibid 8.

However, Platsas' claims raise questions when seen within the context of the questions addressed in chapters five – ten: for example, what do we use as criteria for arriving at a conclusion that English law has a concept of full ownership? In relation to beneficial interest , is it the insolvency effect or the positive and negative powers vested in an owner? Or rather, is it the fact that beneficial interest has a third- party effect (or is a real right)? The same question can be asked regarding the ownership of collateral: do we own collateral because they are transferable, can be vindicated against third parties in certain situations, and can be used to create a security right? Are these criteria, seen independently, adequate to lead to the conclusion, for example, that beneficial ownership is ownership, or that collateral can be the object of ownership?

It has been argued that one way to find a solution to the value-laden process of identifying function is by clarifying whether function refers to the 'intended function' of a legal institution or its 'actual consequences'.[74] It is noted that although the term to 'fulfil',[75] used by Zweigert and Kötz, would seem to refer to the latter,[76] 'function' connotes not just 'any consequence but some consequence that is specified or understood *a priori*. In essence, even if the actual consequence of a legal institution may be identified, it is difficult to tell if a legal institution has fulfilled its function unless the intended function is ascertained. Also, even if one is able to ascertain the intended function, it may be difficult to identify whether the legal institution has fulfilled that function unless one has identified the actual consequences. It is argued that this clarification makes functionalists aware that functions can vary both across and within different societies, and removes the assumption that the functionalist is acting objectively.[77]

In ascertaining function, it may be argued that functionalists pay no attention to the distinction between 'function' and 'effect'. They appear to equate the latter with the former. For instance, the function of the legal principles on delictual liability may be to prevent the intentional or negligent breach of duty leading to the infliction of harm or loss on another. The intended effect will be where the rules are fulfilled by the prevention of intentional or negligent

[74] Christopher Whytock, 'Legal Origins, Functionalism and the Future of Comparative Law' (2009) 2009 Brigham Young University Law Review 1889.
[75] Zweigert and Kötz (n 6) 34. Zweigert and Kötz note that the only things which are comparable are those which 'fulfil' the same function'.
[76] Whytock (n 74) 1889. Whytock does not state why this is so, but it may be implied that 'to fulfil' may refer to the achievement of something desired.
[77] ibid 1891.

breach of duty. But, what of where the functions are not fulfilled? Can the function still be equated with its actual consequences or effects?

This distinction between 'function' and 'effect' has similarity to sociological concepts of manifest functions and latent functions.[78] Manifest functions are consequences which people observe, expect and are aware of. Latent functions are the opposite, that is, actions which are unintended and not expected.[79]

Within another context, it will seem that this distinction may also likely correspond with the legal distinction between the direct and indirect social functions of law. For example, Raz,[80] writing on the social functions of law, gives the example that while criminal law may have the direct function of curtailing the use of violence or other crimes which is secured when the law is obeyed, on the other hand, inculcating certain moral values may be an indirect function of criminal law. Its success consists in something more than the 'mere conformity with the law'.

A similarity exists between Raz's taxonomy and the distinction between latent and manifest function. Thus, manifest function will correspond with Raz's direct function which reflect the intentional objectives to be satisfied, while the latent functions may be the unintended effects of legal rules.

The classification of function in terms of latent or manifest is not without criticism. In sociological theory, the difference between latent and manifest function may be blurry. For example, the actual consequences of an action may be unintended but yet expected to occur.[81] Here the distinction between latent function (a function which people do not expect to occur) and manifest functions (which are expected) becomes uncertain. In relation to the functional method, this suggests that actual consequences or effects may be unintended effects of legal institutions.

It is important to note that Zweigert and Kötz do not provide much guidance regarding the meaning of 'function'.[82] For example, in the chapter on contract across the Germanic, Romantic, Anglo-American and other systems,[83] there is no deliberation on the specific

[78] See Robert Merton, *Social Theory and Social Structure* (Macmillan 1968) 60–69.
[79] Paul Helm, 'Manifest and Latent Functions' (1971) 21 Philosophical Quarterly 51–60; Peter Berger, *Invitation to Sociology* (Doubleday 1963) 40–41.
[80] Raz (n 71) 290.
[81] Helm (n 79) 52.
[82] Husa, 'Much Ado' (n 1) 19.
[83] Zweigert and Kötz (n 6). See part VII of their book.

'function' of contract across these systems. The chapter focuses more on the similarities between the legal rules and principles in relation to 'contractual capacity', 'offer and acceptance', 'formal requirements', etc. Husa confirms this when he notes that the rest of the book does not meet 'the relatively high standards presented in the theoretical part of the book'.[84] Thus to Husa, 'function' may just [be] a loose methodological catchword' which only refers to legal norms or institution or rules and their function within a given context. [85]

To close this discussion, the analysis above suggests that there are uncertainties in terms of what function means: is it actual consequences or effects or 'pragmatic ends', as further suggested by Sjef van Erp elsewhere? [86] As suggested in chapter one, there are suggestions that 'function', in practice, is a flexible term which encompasses all of those terms. This view finds support in the UNIDROIT Convention on Intermediated Securities,[87] and in some of Sjef van Erp's writings. For example, Sjef van Erp applies the method to identify what he describes as a 'transsystemic' European Property Law concept which transcends national systems. [88] In applying the 'functionalist-pragmatic approach', Sjef van Erp suggests that one ought not to aim at any 'exhaustive definition'[89] or 'dogmatic viewpoints',[90] but on how legal concepts work. For example, as will be considered in chapter five, in examining whether German law recognises real right in incorporeals, Sjef van Erp asks us to look at the consequences or the internal content of the rules provided by the German legal system, such as the rules on transfer and the use of such assets in a security device. His conclusions on this issue is unimportant at this stage, but what is important is that he focuses on the effects and consequences of legal rules to arrive at a normative conclusion as to whether claims can be the object of ownership.[91] Therefore, the internal contents or pragmatic ends are what matters to him and the functional method, as suggested by Sjef van Erp.

Sjef van Erp's approach is not different from the approach adopted by the UNIDROIT Convention on Intermediated Securities. The Legislative Guide [92] to the Convention explains that property rights are defined in terms of their effect or result, i.e. as a right which has 'effects against third parties', [93] in the presumption, as affirmed by the functional approach below, that

[84] Husa, 'Much Ado' (n 1) 19.
[85] ibid 14.
[86] Erp, 'European Property Law: A Methodology for the Future' (n 7) 17.
[87] See UNIDROIT Legislative Guide, p. xxiv.
[88] Erp, 'European Property Law: A Methodology for the Future' (n 7) 3.
[89] ibid 16.
[90] ibid 14.
[91] ibid.
[92] UNIDROIT Legislative Guide, p. xxiv.
[93] ibid.

that definition is 'neutral'[94] and therefore compatible with the various legal traditions.[95] What draws Sjef van Erp and the UNIDROIT Legislative Guide together is that they define legal institutions in terms of how they operate, or their consequences or effects. Thus, function is used as synonym for consequences, or effect or pragmatic ends. We will use the term 'function' in this same sense in this thesis.

Nonetheless, there is another issue, which is that terms such as 'full ownership', 'possession and control' are used by the Directive in a doctrinal way, not for example in the same way that UNIDROIT defines property rights or that Örücü above describes divorce. However, as further argued in the next chapter, although some of these terms literally seem to endorse a doctrinal approach, there are implicit presuppositions that those terms are used in the assumption that the effects of equivalent institutions in Member States are the same. First, as discussed in the next chapter, terms contained in EU directives are deemed to be system-neutral. In this light, the presumption is that any term chosen reflects institutions across the Member States which have equivalent effects. This idea is not different from what we see in academic works discussed throughout the thesis, where there are discussions, for example, that the concept of ownership and SFCA (i.e. by way of security) are system-neutral because they give rise to the same effects or have the same consequences. For example, Rahmatian, as will be seen in chapter five, suggests that Civil and Common law both recognise the concept of full ownership. As discussed in the chapter, he makes this argument from a functional perspective, finding similarities in terms of the contents of ownership. Similarly, regarding the meaning of an SFCA (or what amounts to by way of security), Keijser, as will be seen in chapter nine also attempts to find a system-neutral meaning of an SFCA based on certain effects: that is, the no-tradability function.[96] These approaches suggest that although the terms in the Directive, literally, will appear to be doctrinal concepts, they are backed up by presuppositions that they give rise to the same effects or consequences, in the same way that Örücü or UNIDROIT define institutions in terms of specific criteria or effects. What differentiates the different approaches is that the Directive, in most cases, [97] makes implied presuppositions. Besides, interpreting those terms in the Directive in a way to denote they are doctrinal concepts defeats how directives are required to work as anti-doctrinal instruments, as argued in the next chapter.

[94] ibid, p.30.
[95] ibid.
[96] Thomas Keijser, *Financial Collateral Arrangements: The European Collateral Directive Considered from a Property and Insolvency Law Perspective* (Kluwer 2006) 97–100.
[97] As mentioned in chapter one, the Directive in defining a TTFCA and an SFCA provides specific criteria and explicit provisions, although there are implicit presuppositions behind those criteria.

2.3.2 Praesumptio Similitudinis

As earlier mentioned, Michaels notes that domestic laws implementing EU Directives, including the Collateral Directive, are deemed to be 'functionally equivalent'.[98] As will be discussed below, this thinking arguably operates on the assumption of ***p****raesumptio similitudinis*.

One of the assumptions of the functionalist method, as noted, is that the 'legal system of every society encounters the same problems and solve those problems by quite different means, though very often similar results'.[99] According to Zweigert and Kötz, where a functional analysis reveals differences, the functionalist should revert to his research to ascertain if they were formulated in purely functional terms.[100] Therefore, to put the assumption to an effective use, 'all fundamental differences have to be excluded'[101] either in the comparative process or in the outcome of the result which must confirm the assumption. This suggests that the assumption is 'a necessary element of functionalist comparative law'.[102] Its underlying tenet of universal similarity in problems and solutions gives the functionalist analysis a neutral perspective without restriction to local contexts.

One criticism against this assumption is that it gives rise to a bias towards the comparison of similar institutions. Its emphasis on similarity implies that the outcome of the comparative process only confirms a pre-decided formulation.

The assumption may, however, be justified on the ground that, according to Michaels, Zweigert and Kötz were primarily concerned with legal unification or harmonisation. Therefore, the assumption essentially reflects a bias toward that outcome. Furthermore, the assumption has been claimed to also show the 'overall bias toward similarity in traditional comparative law'. [103] However, this point may not totally reflect the position in functional comparative law. A functionalist does not compare only similar legal institutions: '[A]ll things are comparable even if unique',[104] and even identicals must be compared in order to determine if in fact they are identical. Therefore, to determine if institutions are the same or different, the functionalist must look at supposedly different institutions which may have different doctrinal principles but

[98] Michaels (n 1) 377.
[99] Zweigert and Kötz (n 6) 34.
[100] ibid 40.
[101] Frankenberg (n 23) 437.
[102] Michaels (n 1) 370.
[103] Coninck (n 1) 332.
[104] Örücü (n 34) 19.

perform the same function. In essence different institutions may be compared provided they perform the same function.

This bias of the functionalist to find similarities is explained as being a 'rhetorical strategy'[105] which arose immediately after the First World War when comparative law was seen as contributing to the effectiveness of the League of Nations and harmonisation of laws. Although the origin of this assumption can be traced to this source, it still forms part of the functionalist method.[106] Besides, the presumption has been said to be relevant, as it makes a good case for EU harmonisation, since similarities make harmonisation measures 'desirable and decisive'.[107]

The presumption is said to lead to a 'concealed universalism'.[108] This is because it rests on the assumption that systems are similar in terms of the problems and solutions. This position has been criticised on the ground that it leads to the 'misleading imposition of uniformity upon the diversity of social reality'.[109] Similarly, it has been argued that the presumption renders comparative law obsolete as uniformity negates the need for harmonisation. [110] Harmonisation will be unnecessary as laws which are similar need not be altered to complement each other.

It may be that there is something common amongst systems which forms a common denominator for future harmonisation. Hence, systems which are close or similar may be made closer or more similar, even though they may be doctrinally different. This approach underlies the Common Core Project [111] which focuses on factual cases in systems that have distinct doctrinal structures, to ascertain similarities to form the focal point for harmonisation. However, this approach may maintain that differences are impediments to future harmonisation.

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[105] Michaels (n 1) 370; Jonathan Hill, 'Comparative Law, Law Reform and Legal Theory' (1989) 9 Oxford J Legal Studies 101, 110.
[106] See for instance Michaels (n 1) 369; Jan Smits, 'Taking Functionalism Seriously: On the Bright Future of a Contested Method' (2011) 18 Maastricht Journal of European and Comparative Law 554.
[107] Örücü (n 34) 24.
[108] Anne Peters and Heiner Schwenke, 'Comparative Law Beyond Post-Modernism' (2000) 49 International and Comparative Law Quarterly 800, 809.
[109] Pierre Legrand, 'The Same and the Different' in Pierre Legrand and Roderick Munday (eds), *Comparative Legal Studies: Traditions and Transition* (Cambridge University Press 2003) 109 quoting with approval; Alan Hunt, *The Sociological Movement* (Macmillan 1978) 53.
[110] Mathias Siems, *Comparative Law* (2nd edn, Cambridge University Press 2018) 33–34.
[111] See, for instance, the Common Core Project on EU Private Law: Eva-Maria Kieninger (ed), *Security Rights in Movable Property in European Private Law* (Cambridge University Press 2004).The Common Core Project is said to adopt the functional approach; see Graziadei (n 1) 100; Michaels (n 1) 342,see footnote 9; Francesca Bignami, 'Formal Versus Functional Method in Comparative Constitutional Law' (2016) 53 Osgoode Hall L. J 442, 451.

EU Directives, including the Collateral Directive, arguably adopt this approach, as implementing laws are deemed to be functionally equivalent, although doctrinally different. The underlying objective is not to harmonise laws which are already similar, but to better integrate provisions by focusing on similarities. The principle of functional equivalence means that the implementing laws are deemed functionally equivalent, although they may be doctrinally different. In chapters seven and eight, it will be discussed that this may not always be clear. As will be seen in those chapters, it is plausible to argue that both the *fiducia cum creditore* and a legal mortgage in English law are indeed functionally equivalent institutions. They can both be captured within the definition of a TTFCA in the Directive. However, as will be discussed, while a *fiducia cum creditore* is a TTFCA, a legal mortgage is not.

One of the criticisms against the *praesumptio similitudinis* is that it cannot solve issues with systems that are different, since analogies can only be drawn between systems with approximate similarity.[112] However, this criticism may not be accurate when considered from the perspective of looking for functional equivalence between systems which are different but have similar legal institutions performing the same function. The principle of functional equivalence entails some similarity in legal institutions, but only in terms of functions, although institutions may be doctrinally different.

It is important to state that as a working tool, the presumption of similarity allows the functionalist to start with a problem and then look into other systems for solutions. As noted earlier, where the result reveals great differences, the comparatist is directed to cross-check his questions whether they are asked in purely functional terms. This inclination to confirm results by reference to the earlier question may likely make the comparatist insensitive to differences, as it leads to an '*ad infinitum* search for commonalities'.[113] It also vitiates the requirement of 'ideological neutrality'.[114] The outcome of the comparative process by implication only validates the comparative act or the presumption of similarity. [115]

Although the above criticism has some force, it is doubtful if the subjective process through which a functional outcome is reached makes the analysis less valid, except where there is a search for some universal values which ought to appeal to others. Where it is a search for some universal value, subjectivity may be faulty as the criteria employed by the functionalist may not be useful to others.

[112] Husa, 'Back to Basics' (n 1) 553.
[113] Smits (n 106) 557.
[114] Michaels (n 1) 369.
[115] Coninck (n 1) 331.

The clearest way to ascertain the implications of this assumption is to test it within the provisions of the Collateral Directive. The definitions of a TTFCA and SFCA, and the presuppositions contained in the definitions, are all based on the presumption of similarity, that is, that the concepts are similar in all systems.

2.3.3 Function as System-Neutral

As earlier mentioned, the basic methodological principle for the functionalist is that of functionality. The presumption is that function allows the comparatists to maintain a neutral standpoint, deviating from contextual backgrounds. According to Zweigert and Kötz, where function is ascertained, it must be 'cut loose from its conceptual context and stripped of its national doctrinal overtones so that it is seen purely in the light of its function to satisfy a legal need'.[116] However, neutrality in terms of concept is not only achieved by the subtraction of 'function' from its context. Zweigert and Kötz also reasoned that comparatists "must cut themselves loose from their own doctrinal and juridical perceptions and liberate themselves from their own cultural content in order to discover 'neutral' concepts [….]"[117]

To achieve this purpose, Michaels suggests that the functionalist takes an 'observer's perspective' as opposed to a 'participant perspective' which is inherent in contextual analysis.[118] An observer's stance gives the functionalist the neutrality to see the function from the outside, placing emphasis on the effect and disregarding other contextual factors. This deviates from the contextual study of comparative law, which focuses on background data. It is theorized that function transcends the boundaries of national legal concepts and that a focus on contextual factors, such as history, culture, mores, norms and doctrinal formulations, distorts the ascertainment of viable legal solutions.[119] Therefore to achieve the aim of neutrality, legal institutions are defined in 'purely functional terms' in isolation from their context.[120]

Although the functional method defines law in operative terms, it acknowledges that legal institutions have an environment to which they are functionally related in order to fulfil particular legal needs.[121] This idea gives rise to questions as to the relationship between a legal institution and its environment, and whether there are deep structural attachments between both

[116] Zweigert and Kötz (n 6) 44.
[117] ibid 10.
[118] Michaels (n 1) 364.
[119] Frankenberg (n 23) 440.
[120] Zweigert and Kötz (n 6) 34–35.
[121] Coninck (n 1) 333.

as to produce 'stocks of interpretative patterns' which shape the social experiences within specific contexts, therefore negating the flexible transfer of legal rules. [122]

The early literature on the functionalist method did not give a comprehensive theory about the relationship between law and its context.[123] As mentioned earlier, Zweigert and Kötz, for instance, in proposing functionality as the key principle, were not concerned about proffering a self-contained methodology. They only expressed a constructivist theory to act as a practical guide for functional analysis, which required functionalists to simply cut loose functions from their conceptual context. They offered 'little guidance on how to proceed with this'.[124]

After Zweigert and Kötz, the works on the subject have sought to adopt a more sociological structural perspective to the issue of the relationship between law and its environment. [125]As earlier observed, the functionalist comparative law methodology owes some of its tenets to the structural functionalist approach in sociology which treats society as a complex whole with different subsets and social organisations, such as government, law, education and religion.[126] Like the structural functionalist school in sociology, functionalist comparative law, which has been described as a 'vulgar version of sociological' functionalism,[127] also treats law as a subset, structurally and functionally related to the society. The law is conceptualized as an independent sub-system of the social system. [128] Law takes an evolutionary nature and thus adapts to social needs. The evolutionary pattern of law enables it to transcend the boundaries of national legal concepts, as it adapts. However, legal rules are seen to be 'culturally embedded' in the social system. [129] But, as some comparative contextual school may claim, this is not to say that law is seen as a reflection of some underlying social phenomenon. Although functionalism conceptualises law as culturally embedded, they maintain that law can somehow 'be separated from its context' to fulfil a particular social

[122] Frankenberg (n 23) 438.
[123] Rheinstein (n 33) 615–624; Zweigert and Kötz (n 6) first published in 1977.
[124] Coninck (n 1) 336.
[125] Frankenberg (n 23) 438.
[126] Luhmann, 'Law as a Social System' (n 46) 136.
[127] Frankenberg (n 23) 438.
[128] ibid 436.
[129] Michaels (n 1) 364; Legrand makes the same point about law being culturally embedded: Pierre Legrand, 'European Legal Systems Are Not Converging' (1996) 45 Int'l & Comp LQ 52, 56.

function for the social structure, otherwise the law cannot separately 'fulfil a function for the society'. [130]

It is important to note that the sociological perspective of the relationship between law and its context (social system), as endorsed by functionalist comparative law, owes much to the Systems Theory of Niklas Luhmann.[131] Similar to functionalist comparative law, Luhmann conceptualises law as operating in a social system. The law is seen as being functionally related to the social system and performs the function of fulfilling a social need. It serves as a regulatory mechanism, serving the adaptation of society to its environment. It also initiates its own autopoiesis since it is self-regulatory as well as regulating other mechanisms within the social system. The law is an evolving agent capable of adaptation and causing further differentiation.[132] The autopoietic nature of law makes differentiation possible.

While Luhmann's theory focuses on the relationship between law and its context (social system), functionalist comparative law adopts the theory as a tool to conceptualize law as self-sufficient with a functional relationship to the social system. What makes Luhmann's formulation different is that while Luhmann is strictly focused on social structures, functionalist comparative law sees the formulation as a tool to achieve an agenda of comparative law harmonisation. The structuralist thinking makes it possible for law to have a neutral and universal quality, which adapts and transcends local boundaries to fulfil particular social needs.

However, the transposition of sociological structuralist thinking into functional comparative law has not done much to assuage the criticisms expressed relating to the 'legocentric'[133] nature of functionalist comparative law, particularly regarding its quality of confining the ascertainment of legal solutions to purely operative ends. It is questionable how function can be abstracted from its context, making it possible to be isolated from its environment. There has also been criticism against the idea that solutions can be cut loose from

[130] Michaels (n 1) 364.
[131] On the relationship between functional comparative law and Luhmann's Systems Theory: Frankenberg (n 23) 434–435; Luhmann, *Social System* (n 46) 464–490; Luhmann, 'Law as a Social System' (n 46) 136.
[132] Luhmann, *Social System* (n 46) 467.
[133] Frankenberg (n 23) 433.

their context and at the same time be functionally related to their environment in satisfying particular social needs.[134]

To understand the criticism against the functional method, it is important to clarify the separate angles from which these criticisms emanate. On the one hand, we have the perspective which equates law as reflecting the social structures within a system. This perspective views legal institutions as fully integrated within their environment, reflecting the inner dynamics of the social system. It is claimed, as Legrand does,[135] that the law is the product of the living conditions of the people,[136] and that functionally equivalent institutions are what they are because 'they reflect the structure of the legal and social system within which they exist'.[137] On the other hand, the criticism from the second angle is premised not on the nature of legal institutions, but on the inability of the functional method to act as a tool to consider contextual factors. The criticism emanating from this angle is focused on the 'rule-based', 'legocentric' approach adopted by the functionalist method, which sees nothing outside the law. The critics maintain that the functional method is inadequate as it cannot tell us much about the internal structures of a legal system. [138]

While the functionalist method may not have answers to the first angle of the criticism, which tends to view law as a reflection of the inner structures of the social system, it partly answers the second angle of the criticism which maintains that the functional method is inadequate in showing the internal structures of a system. Regarding the former, the point may be made that it is something which falls outside the scope of the enterprise of the functional method. The functional method is itself an alternative to the contextualist study of law. It is inherently pragmatic, rather than analytical. This characteristic may therefore relieve it of the criticism that it fails to consider that the law is a reflection of the structures within a social system, as that issue is something that is mutually incompatible with what it stands for, i.e. the pragmatic focus on the endpoint, rather than the processes leading to that endpoint.

The second angle of the criticism, as earlier mentioned, accuses the functionalist approach of 'legocentricism'[139] and strictly focused on concrete ends; it sees nothing outside

[134] ibid.
[135] Legrand (n 129) 56.
[136] Graziadei (n 1) 118 cited Savigny with approval.
[137] Örücü (n 34) 27.
[138] Siems (n 110) 46.
[139] Frankenberg (n 23) 435.

legal texts. Graziadei, for instance, contends that the functionalist approach obscures the larger picture which should always matter. [140] Frankenberg also argues that 'multiple and cross-cutting processes contributing to the change of legal norms, doctrines and institutions' are dissected only to be translated into one master process without consideration of the larger picture. [141] The consequence of this, as further claimed by Whytock, is that functionalist comparative law reform will likely lead to unintended consequences (either significant or minor) or no consequences at all if they do not consider specific contextual factors. [142]

This criticism may have failed to understand or consider some fundamental tenets of the functionalist method. It would appear that the functionalist method does not totally disregard contextual factors. In fact, Zweigert and Kötz[143] encourage the functionalist to spread his research wide enough by going beyond 'purely legal devices' to other phenomenon 'outside the law'. [144] They further contend that in analyzing a question, one can only discern the accurate position by investigating facts behind the law. Referring to these statements, Michaels concludes that the criticism that the functional method is reductive and does not consider context is a 'flaw in practice, not in the formulation of the method,' as the method supports a consideration of contextual factors.[145]

Although this argument appears to be accurate, it does not eliminate the reductive nature of the functional approach. In relation to the functionalist formulation, this reductive argument may be canvassed from two standpoints. From the first standpoint of the comparative research process (that is, when the legal institutions are still under scrutiny), it will be inappropriate to say that the functionalist does not consider contextual factors, whether legal or non-legal. The comparative research process may require that the functionalist study other non-legal phenomenon to identify why outcomes exist, otherwise how can 'solutions be cut loose from their conceptual context' and stripped of their doctrinal overtones if an attempt is not made to ascertain the context and what the doctrines are. It is only when context is studied that doctrinal formulations bearing functional equivalents and results become obvious. As such, while the student of the functionalist method 'must encompass the law of the whole world, past and present, and everything that affects the law, such as geography, climate and

[140] ibid 118.
[141] ibid 438.
[142] Whytock (n 74) 1879.
[143] Zweigert and Kötz (n 6) 40.
[144] ibid 39.
[145] Michaels (n 1) 364.

race [...] religion and ethics',[146] he is required to exercise caution in the application of this knowledge to the result of his research.

In applying the outcome to a foreign system, the reductive tendencies of the functionalist method emerge. In this respect, the functionalist is asked to 'cut loose from their conceptual context' such solutions and to strip them of their national doctrinal overtones, so that they are seen purely in the light of their function. Hence, while the reductive approach does not arise in the process of ascertaining a solution, it may arise in reconstructing that institution into specific effects or criteria. This drawback therefore applies to the functional method both in its formulation as well as its practice.

The 'legocentric' tendency of the functional method may be seen in particular in the case of EU Directives, especially the Collateral Directive, and how they are prepared and drafted. As seen in the EC Commission preparatory documents to the Collateral Directive, there are references, though not substantial, to Member States and their 'legal traditions' regarding perfection requirements, bankruptcy legislations, title transfer and pledge structures,[147] and the hurdles which arise in individual Member States which impede cross-border transactions. This reference suggests the need for some investigation into the theoretical context of the laws of Member States. However, the end-result (i.e. the provisions of the Collateral Directive) are deemed to be drafted in a way which reconstructs contexts into system-neutral criteria and definitions.

The clearest way to ascertain the accuracy of this is to look at the provisions of the Collateral Directive, such as the definitions in the TTFCA and SFCA, the concepts of 'full ownership', 'by way of security' and 'possession or control', and then identify if these concepts are indeed system-neutral. This is the key question in this thesis, although as suggested from the above discussion, all the assumptions are closely connected: examining one has implications for the others.

2.4 CONCLUSION

It will seem that none of the assumptions of the functional method is based on a scientific, objective fact, as espoused by the method. This is not helped by the fact that most of its assumptions are undertheorized. The method makes assumptions on functionality but fails to

[146] Zweigert and Kötz (n 6) 36.

[147] European Commission, 'Proposed Directive on Financial Collateral Arrangements – Frequently Asked Questions'(Memorandum) (2001) Memo/01/108, pg.2; see also European Commission, 'Proposal for a Directive of the European Parliament and of the Council on Financial Collateral Arrangement', COM (2001) 168 final, para 2.

elaborate how that can be identified. It presumes societies have similar problems and solutions, but this likely seems like a self-imposed assumption, rather than an objective fact. It also makes assumptions about the system-neutrality of rules but offers little guidance on how to procced with this.

A functionalist may justify these inadequacies by arguing that the method is inherently pragmatic.[148] Michaels notes that the pragmatism of the method may be owed to the fact that the founders were not interested in grand methodological expositions, but on more practical matters, universal humanism and the harmonisation of laws. Regardless of this, the question is whether this pragmatism serves the functional method some purpose without the need to provide enough answers for its sceptics? Husa thinks it can, but this means treating the method merely as a 'rule of thumb' or epistemic tool which has a psychological effect: in effect, the comparatist, in trying to achieve a result (either harmonisation, comparative study, etc), comes with the presuppositions or the assumptions discussed above.[149] Husa's advice re-echoes the thoughts of Zweigert and Kötz, who reasoned that it is doubtful if any 'logical or self-contained methodology' of comparative law can be drawn up from any scheme of law or philosophizing. However, they advised that this inadequacy can be covered by applying 'sound judgment, common sense and even intuition' in carrying out any comparative law project, such as harmonisation, unification, etc.[150]

Even if the method is treated as a rule of thumb or epistemic tool, it makes presuppositions which are influential in applied comparative law, such as harmonisation, unification, or other law reform. The next chapter will consider how it has influenced the way directives are framed, in the light of the analytical tools, or assumptions, discussed in this chapter

[148] Michaels (n 1) 362–363.
[149] Husa, 'Much Ado' (n 1) 19.
[150] Zweigert and Kötz (n 6) 33.

3 CHAPTER THREE: DIRECTIVES AS FUNCTIONAL INSTRUMENTS

3.1 INTRODUCTION

The previous chapter discusses the three assumptions of the functional method: first, that the purpose or effect of a legal institution is the key factor in functional comparative methodology; secondly, that societies experience similar problems and provide functionally similar solutions to those problems; thirdly, that institutions can be defined without reference to doctrinal commitments, that is, in a system-neutral way. This chapter demonstrates how EU directives adopt a functional method through the endorsement of the above assumptions.

As noted in section 1.2, the Collateral Directive was adopted by the European Commission (EC) to harmonise the laws of Member States on the use of financial collateral. A directive was adopted on the basis that collateral laws are complex: they are interwoven with other doctrinal areas of law, most especially property, contract and insolvency. The EC opted to use a directive, as opposed to a regulation, to cause as 'little disturbance as possible" to the legal framework in place in Member States.[151] This was designed to deliver legal certainty while permitting doctrinal diversity to continue. Essentially, a directive was adopted with the aim of 'setting out the general objectives' and leaving it to Member States to achieve the results desired under the Directive. [152]

The question is: what makes a directive the most suitable means for this purpose? As will be demonstrated below, EU directives are binding as to the results to be achieved. Thus, they will normally contain objectives, as well as legal norms,[153] which Member States are required to implement. The above presupposes that, at the level of directives, what matters are the results or objectives, not necessarily the doctrinal and contextual means through which those results are to be achieved. This makes it possible to functionally harmonise laws of Member States without interfering too much with the doctrinal structures in the national systems.

In view of the result-oriented nature of directives, and considering that directives are to be implemented by the Member States, certain presuppositions can be drawn: first, directives will necessarily be anti-doctrinal, eschewing reference to national doctrines, since they (directives) are binding only with reference to result or objectives; two, and related to the first, directives will

[151] EC, 'Proposal', para 2.3.
[152] ibid.
[153] Julie Dickson, 'Directives in EU Legal Systems: Whose Norms Are They Anyway' (2011) 17 European Law Journal 190.

normally be system-neutral,[154] since in principle they ought to refer to broader objectives leaving Member States with the liberty to choose how those objectives are to be achieved; three, although directives are anti-doctrinal, they are implemented using national concepts or doctrines. In this context, implementing concepts or laws are deemed to be functionally equivalent providing the same functional solution to the objective contained in the directives.[155] Also, the idea that laws of Member States are functionally equivalent is based on the presumption of similarity, that is, that Member States give similar solutions to the same problem.

Certain questions arise from the above. First, does the fact that directives are anti-doctrinal suggests a similarity with the functional method which is also anti-doctrinal? Secondly, legal norms in the directive are deemed to be system-neutral, without attachment to any national concepts. As noted in the previous section, the functional method also assumes that legal norms can be defined in a system-neutral way by focusing on their function or effect. Thirdly, implementing laws are deemed to be functionally equivalent, thereby giving similar solutions to the same problem. Is this likewise based on the functional method's assumption of similarity?

Although little has been written on the theoretical basis behind how directives operate,[156] there are suggestions that directives presuppose a functional approach. For example, Graziadei notes that the functional method is the backbone of European Community legislation.[157] Although Graziadei does not specify any legislative instrument, it could be that he is simply making a sweeping remark suggesting that EU legislation generally, including directives, are functional. Akkermans similarly suggests that EU law is functional to the extent that they seek to 'eliminate market-access problems and in so doing emphasize the market functionality of legal rules rather than focusing on their doctrinal and/or systematic functioning'.[158] Michaels also notes that laws

[154] This has been noted by some authors. For example, see the following articles which note that concepts in directives are system-neutral. Agnieszka Doczekalska, 'Comparative Law and Legal Translation in Search for Functional Equivalent: Intertwined or Separate Domains' (2013) 16 Comparative Legilinguistics 63, 65; Karolina Stefaniak, 'Multilingual Legal Drafting, Translator's Choice and the Principle of Lesser Evil' (2013) 58 Journal de traducteurs 58, 62.

[155] Michaels (n 1) 377.

[156] The research on directives has focused on how they doctrinally operate. For example, see Sacha Prechal, *Directives in EC Law* (2nd edn, Oxford University Press 2005).

[157] Graziadei (n 1) 113; Michaels (n 1) 377.

[158] Bram Akkermans, 'The Use of the Functional Method in European Union Property Law' (2013) 2 European Property Law Journal 95. A work of the same title and the same author is available at < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2228641> accessed 12 November 2017. Subsequent citations are from this SSRN copy. Akkermans 'alternative functionalism' already finds support in how directives operate: the results in directives are binding only for the purpose of enhancing market access (in the case of private commercial law). The Member States are at liberty to use their own laws to determine the form of implementation.

implementing directives are functionally equivalent. As will be argued below, these similarities suggest that directives are functional. The chapter will build on these views, and will argue that directives presuppose a functional approach.

3.2 EU DIRECTIVES AS RESULT-ORIENTED INSTRUMENTS

By Article 288 of the Treaty on the Functioning of the European Union (TFEU),[159] EU institutions can adopt a regulation, directive, decisions, recommendations or opinions in fulfilling the Treaty objectives. Article 288 of the Treaty provides:

> To exercise the Union's competence, the institutions shall adopt regulations, directives, decisions, recommendations and opinions.

Article 288 further explains the effect of each of these instruments:

> A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States. A directive shall be binding as to the result to be achieved upon each Member States to which it is addressed but shall leave the national authorities the choice of form and methods. A decision shall be binding in its entirely upon those to whom it is addressed. Recommendations and opinions shall have no binding force.

This section focuses on directives, but it is important to contrast it with another instrument, i.e. a regulation. In contrast to directives, regulations are directly applicable. This means that, in principle, they are automatically incorporated into the domestic legal system of the Member States once they come into effect.[160] Therefore, they form part of the domestic legal system and need no transposition.[161] Unless specified in the regulation, it is illegal to adopt an implementing measure because the measure may contain changes that affect the objectives. It may also obscure from citizens that the source of their right is a regulation.[162] Because of this, regulations are adopted where there are minimal differences between systems.

[159] [2012] OJ 326/47
[160] Prechal (n 156) 14 .They may require adoption of national measures to make them fully effective.
[161] Damian Chalmers, Gareth Davies and Giorgio Monti, *European Union Law* (3rd edn, 2015) 112.
[162] ibid.

Regulations are therefore centralising norms and useful when the objective is one of uniformity rather than harmonisation of rules.[163] Since they have general application, they apply to an 'objectively determined situation' to produce legal effects in a generalised way.[164]

Unlike regulations, directives are not directly applicable. Instead, they are binding as to the 'results'. The TFEU leaves it to the Member States to determine the form and methods to be used to achieve those results. Therefore, directives, unlike regulations are, not 'self-sufficient'[165] and self-executing. In order to be effective, an implementing measure is needed at the national level. Also, unlike regulations, directives involve a two-stage process: the first is the process of enacting the directive which specifies the result to be achieved. The second is the transpositions into national law by a legislative instrument or other methods.

Before considering the effects of the distinction between directives and regulations, the first question to be posed is: what is meant by 'result'? Literally, it will seem that what amounts to 'result' will be dependent on the directive in question, as different directives can have different objectives. Prechal notes that the German version of the Treaty uses '*Ziel*' ('objective') in place of 'result'.[166] She notes that the term is defined in German literature to mean a general legal, economic, or social situation or a 'legal or factual situation which does justice to the Community interest which, under the Treaty, the directive is to ensure'.[167] Prechal notes that based on this definition the result may concern both the state of affairs in law and in fact and must be situated within one or more objectives of the Treaty. This suggests, according to her, that the result will be dependent on the specific directive in question.

Prechal's views suggests that it is impossible to get an abstract meaning of the term 'result' because the result is relative to the particular directive. This implies that the term is not a technical one but is closely linked to how the term is used colloquially, to refer to an aim or a goal of the EU.

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[163] ibid.
[164] ibid.
[165] Prechal (n 156) 92.
[166] See Article 288, German version of TFEU.
[167] Prechal (n 156) 40; Schmidt, *Gemeinsame Vorschriften Fur Mehrere Organe, Von Der Groeben Schwarze (Hrsg) Vertrag Uber Die Europaische Union Und Vertrag Zur Grundung Der Europaischen Gemeinschaft*, vol IV (6th edn, 2004) 786; Paul Kapteyn and Pieter Verloren van Themaat, *Introduction to the Law of European Communities* (Laurence Gormley ed, 3rd edn, Kluwer law International 2015) 328.

As noted earlier, the operation of directives, unlike regulations, confers more latitude to the Member States. The reason may be because of the lack of competence of the European Union to legislate on certain matters, especially matters falling with the internal market purview touching on private law.[168] Prechal notes that directives are important in areas where national law is complex.[169] As suggested earlier, this similarly underscores the reason why a directive was adopted in relation to the Collateral Directive. It was the EC's view that the areas of law surrounding collateral were rather complex dealing with creditor's rights, property, contract and insolvency. A directive was therefore adopted setting out the objectives with the view of leaving Member States to adopt measures to harmonise existing law to comply with the Directive.[170] Primarily, it was the difficulty, particularly arising from the doctrinal differences, which made it necessary to adopt a directive.

Directives are therefore not suitable where national concepts do not produce an 'objectively determined situation', as Chalmers *et al* suggest above.[171] It follows that the most important area where directives are needed is to harmonise rather than unify legal provisions.[172] This makes a directive an instrument of 'limited intervention' which is associated with the principle of subsidiarity, acknowledging that some decisions are best made at the level of the Member States.[173]

The use of directives raises certain presuppositions. First, there is an implied acknowledgement that the laws of Member States are different. However, this acknowledgement may not matter with reference to directives alone since regulations are also premised on some notion of differences in laws. If laws were not different, the need to unify or harmonise does not arise. Therefore, implicit in the use of regulations and directives is the acknowledgement that systems are different.

The difference between a directive and regulation, as noted by Prechal above, is that directives are used where the area of law is 'complex and voluminous'. This may, however, be

[168] Florian Möslein and Karl Riesenhuber, 'Directives' in Jürgen Basedow and others (eds), *Max Planck Encyclopaedia of European Private Law* (Oxford University Press 2012) 462–463.
[169] Prechal (n 156) 3.
[170] EC, 'Proposal', para 2.3.
[171] Chalmers, Davies and Monti (n 161) 112.
[172] Piet Jan Slot, 'Harmonisation' (1996) 21 European Business Law Review 378, 380; Bartlomiej Kurcz, 'Harmonisation by Means of Directives – Never-Ending Story?' (2001) 12 European Business Law Review , 287–307.
[173] Prechal (n 156) 3–4.

another way of saying that directives are suited for areas of law, especially private law, which are technical and have a detailed theoretical framework.[174] This makes them very difficult to change. Therefore, because of the difficulties in formulating a uniform rule in these areas, a practical response is given which focuses on the results.

This suggests that directives are 'pragmatic' instruments suited as a response to institutions which are doctrinal. They are inherently pragmatic since they are focused on results, and to ensure that the 'practical effects' of those results are met within the system.[175]

The above necessarily presupposes that directives are functional instruments. As noted in the previous chapter, the functional method is a reaction to the contextual study of legal institutions. As Michaels notes, the functional method does not focus on doctrinal structures but on problems.[176] It is 'anti-doctrinal'[177] and 'asks us to understand legal institutions not as doctrinal constructs but as societal responses to problems'.[178] Similarly, directives, as Michaels equally suggests, are anti-doctrinal. They are binding only as to the results to be achieved. As noted, the result will often be a set of facts, and legal institutions in the Member States are defined in terms of how they respond to the issues underlying those results.

Both the functional method and directives thus appear theoretically to define institutions in terms of their consequences. They both reject the idea that legal norms have, as Michaels suggests, an inherent characteristic or 'essence' defined by their context.[179] The functionalist defines legal institutions in terms of their function to provide a solution to a problem. The functional relation between problem and solution is determinant. Similarly, because directives are binding only as to the results, this means that, in principle, legal institutions are seen in terms of their 'functional relation' to how they achieve those results and not in terms of any inherent characteristic. Therefore, both the functional method and EU directives are result-oriented, defining institutions in terms of their purpose or operative ends.

However, one question is whether the anti-doctrinal, result-oriented nature of both the functional method and directives are premised on the same presupposition? It seems that both are premised on the idea that national concepts are a hindrance to closer harmonisation. Regarding the functional method, Zweigert and Kötz, as noted earlier, saw the functional method as a good

[174] Michaels also makes this suggestion: Michaels (n 1) 377.
[175] Möslein and Riesenhuber (n 168) 463.
[176] Michaels (n 1) 342.
[177] ibid 372.
[178] ibid 364.
[179] ibid 356.

tool to break down national doctrines and provide some objective basis to 'build a system' which is 'flexible and has large concepts to embrace the quite heterogenous legal institutions which are functionally comparable'.[180] Although they speak in terms of 'system-building', the meaning of this, as they noted in the introductory chapter of their text, is to reduce the 'discrepancies between national legal systems[….]'[181] by providing objective standards which cuts across systems.[182] This will equally seem to be the core objective of directives. Directives seek to primarily harmonise by focusing on areas of similarity. Thus, it cuts discrepancies in the laws of Member States by a close approximation of the laws through laying down specific standards which Member States have to satisfy.

The discussion above indicates that there is a close relationship between the functional method and directives in terms of their theoretical underpinning. They are both anti-doctrinal, and they both define legal norms in terms of their functional relation to certain goals (problems and results) and are therefore both result-oriented: they define norms in purposive terms, rather than on the basis of any intrinsic quality. These similarities therefore suggest there is some connection in terms of the theoretical principles on which they are based.

Three objections may be raised in relation to the above: first, that while the functional method starts its analysis from 'real life problems',[183] directives on the other hand are focused on 'results'; secondly, directives are strictly concerned with legal norms unlike the functional method which goes beyond 'purely legal devices to extra-legal phenomenon' and to even matters regulated outside the law;[184] thirdly, that the functional method is non-causal unlike directives which may be causal. In this regard, Michaels notes that for the functional method, what is similar is neither how particular problems (or causes) lead to particular solutions (effects), but the functional relation between problems and different solutions. Therefore, the similarity between solution A in society 'XYZ' and solution B in society 'ABC' is not the separate problems to which they give solutions, but to a specific problem which they both provide a functionally similar solution to. In relation to directives, Doczekalska suggests, on the contrary, that directives are causal because they are concerned with institutions that have the same legal effects.[185] In other words, they are concerned with the causal connection between legal problems and the legal solutions in Member States.

[180] Zweigert and Kötz (n 6) 44.
[181] ibid 24.
[182] ibid.
[183] ibid 34.
[184] ibid 38.
[185] Doczekalska (n 154) 71.

The last two objections above will be considered in the section below, because they relate to the idea of comparison of either legal or non-legal institutions between national systems. Within the context of directives, this issue arises in relation to the implementation of directives, that is, a) are the different implementing laws of Member States defined in terms of their causal connections between legal institutions and the result specified by directives? b) is it possible to use non-legal norms to achieve the objectives specified by the relevant directives? These questions will be considered below.

Regarding the first objection above, that the functional method is concerned with problems, unlike directives which are concerned with 'results', the question is: what does the discussion of the term 'problem' mean? As suggested in sections 1.1.1 and 2.3.1, within the context of the functional method, that term is not a term of art. It seems to be synonymous with 'function', or the reason for a rule.[186] For example, Zweigert and Kötz, as noted in the previous chapter, use it in a way to mean the situation for which a legal rule is provided. According to them: "the problem must be stated without reference to the concept of one's legal system. Thus, instead of asking, 'What formal requirements are there for sales contracts in foreign law?' it is better to ask, 'How does foreign law protect parties from surprise, or from being held to an agreement not seriously intended?"[187]

The quotation above suggests that the functional method is concerned with concrete issues behind legal rules. As noted in the previous chapter, the aim is to express legal rules in a functional way, on the assumption that they become system-neutral, without any contingent value. Thus, the method, according to Chirico and Larouche, relies on a 'set of facts as a starting point'.[188]

Directives have also been said to rely on a 'set of facts' as a starting point. Chirico and Larouche, in observing that directives are not devoid of values and choices, suggest that directives are based on a set of facts. They suggest that the reason for this may be because directives set objectives which are 'common to all legal systems'; they apply to all Member States.[189] This comment may be interpreted to mean that in terms of content, results/objectives are stated in a factual way, focusing on what needs to be done, as normally seen in the Recitals of most directives.

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[186] Coninck (n 1) 323.
[187] Zweigert and Kötz (n 6) 34.
[188] Filomena Chirico and Pierre Larouche, 'Conceptual Divergence, Functionalism & Economics of Convergence' in Sacha Prechal and Bert van Roermund (eds), *The Coherence of EU Law: The Search for Unity in Divergent Concepts* (Oxford University Press 2008) 478.
[189] ibid.

As suggested, the content of directives, specifically the Collateral Directive, endorses this position. Looking specifically at the Recitals of the Collateral Directive, it is obvious that the European Commission sticks closely to facts in expressing the objectives of directive. Although the terminology may inevitably be legal in nature and consequently not devoid of contingent values, as Chirico and Larouche note above , there is a deliberate attempt to use factual, colloquial words, referring to concrete issues. In this regard, it is important to note that the *Joint Practical Guide* for drafting European Union legislation requires that 'everyday language be used' in EU legislation, including directives.[190] The primary reason for this, as Doczekalska notes, is to render them neutral for systems to easily understand.[191]

In terms of the similarity between problems (functional method) and results (directives), the above demonstrates that the term 'results' used in relation to directives may be synonymous with 'problem' if that term is taken to refer to specific problems for which EU institutions are concerned with and thus provide results for. Importantly, it will seem that rather than focus on what amounts to problems, Zweigert and Kötz were concerned about the how those problems are to be articulated and the solution provided by a rule. In this light, the discussion in the previous paragraph indicates that both the functional method and directives start from a similar starting point: a set of facts. As also stated above, the reason why they both start from this point is because of the presumption that it is easier to see through what is common to all systems that way.

The following conclusions can be drawn from the above: First, both the functional method and directives are anti-doctrinal. Secondly, both define institutions in a purposive way, as a functional relation to how they satisfy a goal. Thirdly, both rely on a set of facts on the epistemic assumption that it makes the legal issues system-neutral.

The discussion above demonstrates the theoretical underpinnings of directives and how they are linked with the functional method. However, there remains a question regarding the internal content of directives and, importantly, whether directives in the way they are implemented are indeed functional. In the sections below, we will consider this issue. However, before we proceed with this, it is important to consider the provisions of Article 288 TFEU above, particularly the meaning of the phrase that the 'choice of form and methods' in implementing directives are left to the Member States.

[190] European Commission, 'Joint Practical Guide of the European Parliament, Council and the Commission for Persons Involved in the Drafting of European Union Legislation' (Joint Practical Guide) (2015), 11
[191] Doczekalska (n 154) 67.

3.3 DIRECTIVES: *VERBATIM* AND EFFECTIVE TRANSPOSITION

As already mentioned, although directives are binding as to the result to be achieved, Article 288 TFEU leaves it to Member States to choose the 'form and method' to achieve the result. Prechal notes that there are two reasons for this provision. First, there is the need to respect the sovereignty of Member States. Secondly, it also allows Member States to take account of their national peculiarities when implementing a directive.

But there is a question as to what is meant by the phrase 'form and method'? The meaning of the term is not clear. [192] Fuß suggests that 'form' refers to the specific type of rule which a national system enacts, while the 'method' refers to the political, economic, financial or social measures.[193] Oldenkop further argues that 'form' refers to the mode in which the measures are made and their legislative appearance in either a statutory form or through state regulations, while 'methods' refers to the measures taken by the Member State.[194]

The European Court of Justice appears to treat the phrase as unproblematic. In *Von Colson*',[195] the court uses the phrase 'ways and means' and 'form and methods' synonymously – suggesting that their meaning is clear. In considering the meaning to be ascribed to the phrase, the court further held that the Article imposes an obligation on Member States, 'to adopt in their national systems, all the measures necessary to ensure that the directive is fully effective, in accordance with the objective which it pursues'.[196]

This implies that Member States have the liberty to adopt any measure which may achieve the result. This may take different forms. First, implementation may be a *verbatim* transposition.[197] As will be seen in chapter ten, this seemed to be the method adopted by the UK Regulations implementing the Collateral Directive, specifically the provisions on possession or control. The advantage of *verbatim* implementation is that it gives an impression that the directive has been correctly implemented.[198] On the other hand, its disadvantage is that words adopted

[192] Prechal (n 156) 73; see also the first edition of her book: Sacha Prechal, *Directives in European Community Law: A Study of Directives and Their Enforcement in National Courts* (1st edn, Oxford University Press 1995) 86–88.
[193] Fuβ, Die *Verantwortung der nationalen für die Wahrung des Europäischen Gemeinschaftsrechts*, in Bieber, Blackmann, Capotorti et al (eds), *Das Europa der Zweiten Generation (I) Gedächtnisschrift für Christoph Sasse, Nomos, Baden-Baden* 1981.
[194] Oldenkop, *Die Richtlinien der Europäischen Wirtschaftsgemeinschaft*, *JöR* 1972, 55.
[195] Case 14/83 *Von Colson* [1984] ECR 1891.
[196] ibid, para 15.
[197] Prechal (n 156) 32.
[198] ibid.

directly may be unfamiliar to the local context. As will be seen in chapter ten, this problem arises within the English law context of identifying the meaning of 'possession or control' as used in the Collateral Directive, which was transposed verbatim into the UK regulations. The UK authorities implemented this provision without consideration of how English law concepts can be used to achieve the result desired.

Prechal notes that in implementing directives, the obligation imposed on Member States goes further than the text of the directive and its transposition as national law.[199] She points out that the implementing measures must correspond to the internal substance of the directive and must ensure that the directive is fully effective in accordance with the result it specifies.[200] This implies that the implementing legislation must have the same legal effects produced by the directive.[201] Prechal notes that the 'preferable' method which corresponds with the character of directives is to implement them by way of translation into national law, through equivalent institutions which achieve the same purpose. [202] Obviously, this implies that there needs to be an understanding of the broader principles of the particular directive, and then the adoption of local concepts to achieve those principles.

Lord Reed re-echoes Prechal's advice with reference to intra-national conventions which impose a ratification obligation on the UK. Writing specifically on the availability of local concepts to achieve the same result under the European Convention on Human Rights, Lord Reed highlights the particular propensity of UK courts to rapidly refer to, and directly apply, the guarantees under the Convention when there are equally local concepts which achieve the same purpose or make similar guarantees, and which the courts can refer to in the first instance.[203] Lord Reed therefore encouraged UK courts, when faced with questions on the requirements of the Convention, to identify the broader, high-level principles underlying the guarantees in the Convention and then search for local concepts which achieve the same result. Primarily, Lord Reed highlights the availability of equivalent local institutions to achieve the result set out in inter or intra-national legal instruments, which is a similar expectation in relation to EU directives, that is, there are equivalent concepts which can achieve the same purpose in directives.

[199] ibid 31.
[200] ibid 3. See also Case 14/83 *Von Colson* [1984] ECR 1891
[201] ibid 31.
[202] ibid 33.
[203] Lord Reed, 'Human Rights and Domestic Legal Traditions' in Ross Anderson, James Chalmers and John MacLeod (eds), *Glasgow Tercentenary Essays: 300 Years of the School of Law* (Avizandum Publishing Ltd 2014) 171–172.

Prechal and Lord Reed therefore highlight the possibility of using local concepts to fulfil the results set by intra-national conventions or other legislative instruments, such as directives. However, as Prechal notes, there is the risk that such institutions which appear equivalent may in fact not be so.[204] As will be seen in chapters five, eight, nine and ten, this risk arises in relation to the meaning of a) a TTFCA,[205] b) the term 'full ownership',[206] and c) the meaning of 'possession and control'.

Because directives are binding as to the results, it is irrelevant if Member States implement the content of the Directive by *verbatim* implementation or implementation using local concepts. What matters is that national implementing laws satisfy the objectives in the directive. Where directives are implemented, Michaels notes that national implementing laws are not similar but are deemed to be functionally equivalent.[207] Chirico and Larouche also make this point that an EU 'directive is an ideal canvas against which to study the possibility of functional equivalence'. [208] This means that implementing laws are presumably deemed to give functionally similar solutions to the same problem.[209] This observation re-echoes the presumption of similarity endorsed by the functional method.

The above point suggests that it is the implementing laws which are functional or functionally equivalent, not necessarily the directives themselves. However, as we will see below, one of the primary aims of the functional method, as Michaels notes, is to identify similarities, to enable lawmakers to write an 'optimal law' or system-neutral provision which transcends the doctrinal peculiarities of local systems.[210] As noted earlier, Zweigert and Kötz also make this point.[211] Thus, because systems have similar institutions which give functionally similar solutions to the same problem, it is possible to have a system-neutral provision on the basis of that similarity. But the questions, in relation to a directive, are: a) how are implementing laws functionally equivalent and b) are directives indeed system-neutral? We will consider the first question below and the second subsequently.

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[204] Prechal (n 156) 33.
[205] As discussed in chapter six, the drafting suggests that a legal mortgage falls within the scope of the definition.
[206] As discussed in chapter five, the drafting suggests that beneficial ownership does not fall within the scope of the definition.
[207] Michaels (n 1) 377.
[208] Chirico and Larouche (n 188) 478.
[209] Michaels (n 1) 360–370; Chirico and Larouche (n 188) 478.
[210] Michaels (n 1) 376.
[211] Zweigert and Kötz (n 6) 44.

3.4 IMPLEMENTING LAWS: FUNCTIONAL EQUIVALENCE AND PRESUMPTION OF SIMILARITY

As mentioned, Michaels, [212] as well as Chirico and Larouche,[213] make the point that laws implementing directives are presumed to be functionally equivalent. As seen in the previous chapter, the functional method similarly endorses the view that societies experience similar problems and give similar (functionally equivalent) solutions to those problems. Considering the comments of the authors above in the light of this functional assumption, it will seem that there is a similarity between the assumptions underlying how directives operate and the functional method. This may be another indicator that directives presuppose a functional approach. The discussion below considers this.

The idea of equivalence functionalism (*Äquivalenzfunktionalismus)* was popularised by Niklas Luhmann whose ideas on structural-functionalism had an influence on functionalist comparative law, as specified in the discussion earlier. Luhmann's equivalence functionalism was a reaction to causal functionalism which explained social problems by drawing a causal link between problems and solutions.[214] Luhmann rejects the idea that problems are causes and solutions effects in a deterministic way, so that the solutions are somewhat inherent in the problem.[215] He notes that equivalence functionalism studies solutions not in the light of their immediate causal problems but in the light of other solutions. According to Luhmann, the aim of the functional method is not to study causal relations between particular problems (causes) and then the solutions (effects) arising as a result of that particular problem. Instead, the aim is to compare different solutions as a response to a singular problem.[216] Different solutions to a given problem are deemed to be functionally equivalent. Luhmann's equivalence functionalism, in essence, treats solutions as a 'possible', but not a necessary, reaction to a problem.[217]

What is debatable is the extent to which the functionalist comparative law borrows from Luhmann's theory. But we can clearly see some similarities, as well as differences, between the two. Regarding the similarity between the two concepts, Zweigert and Kötz, as seen in the previous chapter, note that in comparative law incomparables cannot be usefully compared, and in law the

[212] Michaels (n 1) 377.
[213] Chirico and Larouche (n 188) 478.
[214] Niklas Luhmann, *Soziologische Aufklärung 1: Aufsätze Zur Theorie Sozialer Systeme* (Opladen: Westdeutscher Verlag 1991) 13, cited in Morten Knudsen, 'Surprised by Method – Functional Method and Systems Theory' (2010) 36 Historical Social Research 124, 128.
[215] Knudsen (n 214) 128.
[216] Luhmann, *Soziologische Aufklärung* (n 214) 13; cited in Knudsen (n 214) 128.
[217] Michaels (n 1) 358.

only things which are comparable are those which are functionally equivalent. They went further to make some universalist claims that all societies face similar problems and solve those problems by quite similar results.[218] In examining this statement, Michaels notes that if it is only functionally equivalent institutions which are comparable, it means that, applying the presumption of similarity, they must be similar in the sense that they respond to the same problem. Michaels further notes that what is presumed to be similar are neither the legal institutions nor the problems to be solved by the institutions, but the functional relation between problems and solutions. Thus, if a society has a certain problem *XYZ*, it must have a legal institution *Y*, and different solutions to *XYZ* by different systems are deemed to be functionally equivalent. As mentioned in the previous chapter, tort law and insurance law, according to Michaels, are not similar because they fulfil the same function of providing accident victims with compensation. They are similar because they provide solutions to one specific problem. According to Michaels, this is not similarity, but functional equivalence, that is, they both provide solutions to a specific problem. Essentially, this re-echoes Luhmann's theory, rejecting any causal connection between problem and solution; solutions ought to be studied as a response to a specific problem, not really as a causal phenomenon arising from a problem.

However, the functional method adds another perspective to Luhmann's theory. It treats problems and solutions as universal, that is, the so-called *praesumptio similitudinis*. This implies that 'every society faces essentially the same problems and solves these problems by quite different means though similar results'.[219] As discussed in the previous chapter, this presumption is a strategy to aid harmonisation,[220] and is a 'rational tool for convergence'. [221]

As Michaels notes, implementing laws in respect of EU directives are deemed to be functionally equivalent. The question therefore is whether this idea of functional equivalence is the same as the functional equivalence of the functional method?

Doczekalska writes on this point but from a different perspective. She considers EU legislation, including directives, from the view that they are normally translated into the languages of the different Member States. She then considers whether the different language translations are functionally equivalent to each other, and whether the idea of functional equivalence in legal translation studies is the same as the idea of functional equivalence in the functional method.[222] Although she does not write directly on the implementing laws (but writes instead on different

[218] Zweigert and Kötz (n 6) 34.
[219] ibid.
[220] Michaels (n 1) 370; Hill (n 105) 110.
[221] Husa, 'Much Ado' (n 1) 18–19.
[222] Doczekalska (n 154) 71.

language translation), her ideas, as seen below, provide some hint regarding the nature of implementing laws. As she suggests in her writeup, the translation of the different language versions of EU directives will often involve comparing the source language with the domestic concept in the target system (Member States).[223] This means that when Doczekalska writes about whether the different translations are functionally equivalent, this also may relate to the concepts in the national system.

According to Doczekalska, both the functional method and directives start from the idea of a social problem. Thus, if two legal institutions respond to the same problem, they are functionally equivalent.[224] Thus, like the functional method, directives start from the idea of a social problem: the institution serves the purpose of solving a legal problem. However, Doczekalska further suggests that the functional method and directives are different in the way they describe functional equivalence. She argues that for the functional method, a given problem may be addressed by a whole branch of law or a norm which does not create a legal concept. Thus, a functionally equivalent institution may, or may not, be a legal concept or norm, since, as noted earlier, the causal link between problem and solution is not considered vital by the functional method.[225] Regarding directives, she suggests that two terms are functionally equivalent when they denote concepts or institutions which have corresponding legal effects. In addition, the structural and systematic embedding of the concepts must be similar, i.e. they must belong to the same branch of law, unlike the functional method which is 'oblivious to the correspondence of legal effects and to the similarity of structural and systematic embedding of the compared concepts'.[226] In essence, she argues that while directives and implementing laws deal with legal norms which have corresponding legal effects, the functional method may deal with non-legal norms.

This view is similarly endorsed by Zweigert and Kötz who advised the comparatists to look outside the law for functionally equivalent institutions. Thus, in finding functionally equivalent institutions, a functionalist considers other social or economic norms which may provide a solution to the same problem. Therefore, Doczekalska is right on the fact that the functional method may deal with non-legal norms – a point stated by Zweigert and Kötz.

However, it is inaccurate to argue that because the functional method considers non-legal norms, that it does not also consider legal norms. For instance, Zweigert and Kötz note that in

[223] ibid 64.
[224] ibid 71.
[225] Zweigert and Kötz (n 6) 39.
[226] Doczekalska (n 154) 72.

functional research, there may be 'instances of replacement of one legal rule by another, albeit of a different conceptual stamp'.[227] However, they further note that the 'comparatist must go beyond the purely legal devices, for he finds that the function performed in his own system by a rule of law is performed in a foreign system not by a legal rule at all, but by an extralegal phenomenon'.[228] This obviously suggest that legal rules have as much importance as non-legal rules. Although Doczekalska is right that the functional method considers non-legal rule, the method also considers legal rules. As such, although directives are concerned with only legal norms, this does not exclude the fact that they can be functional. In other words, the sole consideration of a legal rule – in this case by directive — does not exclude the possibility that the approach it adopts is functional.

The above point regarding non-legal rules raises a broader issue in relation to the use of the functional method. There seems to be a misconception about how to apply the assumptions of the functional method to certain areas, most especially projects dealing exclusively with harmonisation. This can be detected in Doczekalska's argument.

Zweigert and Kötz identified four functions of comparative law and then identified the functional method as a tool to achieve these functions.[229] First, they note that comparative law can be a tool for legal research and reconstruction of legal systems. Secondly, it acts as a practical aid for interpretation of laws within a system. Thirdly, it offers new dimensions to students of legal education to learn new laws. Fourthly, it is also a tool for legal harmonisation and unification of law, and as a tool for the development of private law common to the whole of Europe.

Zweigert and Kötz fail to highlight this, but it is impracticable how some of the assumptions of the functional method may apply to fulfil some of the functions stated above. For instance, Zweigert and Kötz advise the functionalist to go outside law to identify legal norms. However, it is questionable to what extent this directly applies, for example, to harmonisation of laws which often focuses on approximation of legal rules. Because such projects focus on legal rules, it is expected that its subject matter will strictly be legal institutions and concepts. As an example, the UNIDROIT Convention, as was seen in the previous chapter, is one legislative instrument which expressly adopts the functional approach. Like the Collateral Directive, the Convention is concerned with legal institutions dealing with the provision of collateral and thus is concerned with only legal rules and principles. It is therefore difficult to see the place of non-legal norms in the consideration of an area which is primarily regulated by legal rules. [230]

[227] Zweigert and Kötz (n 6) 38.
[228] ibid.
[229] ibid 16.
[230] See UNIDROIT Legislative Guide, paras 65.

In line with the above, the functional method, as expounded by Zweigert and Kötz, may metaphorically be seen as a 'toolkit' containing some analytic devices and assumptions. Some of its assumptions may simply be 'tools' which may not be useful in specific contexts. Depending on the project, some of the assumptions may either be appropriate or inappropriate. For example, in the case of a research project to identify institutions which provide better solutions, it is appropriate to refer to non-legal norms to determine how they may provide an answer to that problem. For this the functional method provides good tools. It starts from the problem and then looks for legal and non-legal solutions across systems. This type of agenda may be normal in legal research or legal education or reconstruction of a system, which, as noted, are all areas the functional method aims to improve. Therefore, it is not necessary to consider non-legal norms where the focus is harmonisation of laws, which consider existing legal rules.

Although Doczekalska disagrees that the functional equivalence of the functional method is the same with that of directives, her views, as seen below, provide hints regarding how directives operate – from which we can then extrapolate certain conclusions. As earlier noted, she notes that for directives, two terms are functionally equivalent when they denote concepts or institutions which have corresponding 'legal effects' and 'functions'. [231] The question is: what does it mean to define institutions by their legal effects and functions?

When an institution is defined by it 'legal effects', this will generally mean it is defined by how it works or by its results. We can contrast this with the situation where such an institution is defined in a doctrinal way, in which case a more ontological approach is taken which refers to the substance or conceptual makeup of the institution. As noted in the previous chapter, the functional method likewise defines institutions in terms of their legal effects. This therefore raises doubts about whether Doczekalska's argument is, in any way, different from the approach adopted by the functional method. Based on Doczekalska's argument, national concepts are functionally equivalent when they have the same legal effects. This is not different from how the functional method defines legal rules. Therefore, both EU directives and the functional method are purposive. More importantly, this implies that there is a clear parallel between the functional method and EU directives. In relation to directives, institutions are deemed to be functionally equivalent when, according to Doczekalska, they have the same legal effects pertaining to a problem. In other words, they are defined in terms of the solution they provide for a given problem. This is not different from the functional equivalence of the functional method, which also identifies functionally equivalent institutions in terms of how they provide solutions to a problem.

[231] Doczekalska (n 154) 71–72.

One remaining issue is to identify how the presumption of similarity operates in relation to EU directives. Within the context of the functional method, the presumption has been criticised as not based on any objective, scientific criteria, but on some inane idea of 'primal human similarity'.[232] The presumption has also been criticised as lacking any 'empirical claims' but is only an analytical and constructive tool used by the functional method.[233] Zweigert and Kötz were equally aware that the presumption lacks any objective basis. Nonetheless, they accepted that the assumption merely acts as a 'heuristic principle' to guide the functionalist in looking for similarity. In a way, this presumption acts merely as an epistemic guide, providing the functionalist with intellectual tools to 'make sense of the data [they] find'.[234] Essentially, the presumption is a pragmatic tool, which is adopted to break down barriers of doctrinal structures, to impose some form of similarity on systems.

Within the context of EU directives, the implementing laws in respect of EU directives are deemed to be functionally equivalent. This means that systems are deemed to give functionally similar solutions to the same problem. However, the premises on which this idea stands are not clear: why are systems deemed to be functionally equivalent? Any answer to these questions points towards the categories of the legal families which make up the EU (Civil law, Common law and so-called 'Mixed Systems')[235] and their doctrinal differences. Particularly, within the EU there are many systems with different doctrinal structures. The doctrinal difference between the systems suggests that problems and solutions are different in these systems. If they are the same, then obviously harmonisation will be unnecessary. However, harmonisation projects and instruments, such as EU directives, seek to minimise these differences by functionally converging their respective rules. It will therefore seem that implicit in such projects or instruments is the assumption that the systems are indeed different. However, to bring the systems together – not doctrinally but functionally— it becomes necessary to assume that the systems are similar in terms of the legal effects which their various institutions give rise to. This necessarily implies similarity. Moreover, how can systems have institutions that produce the same legal effects if the problems and effects (solutions) are not the same?

The above suggests that the presumption of similarity particularly arises because of a) the differences in systems, b) the need to harmonise those differences. Thus, because

[232] Husa, 'Much Ado' (n 1) 20.
[233] Coninck (n 1) 350.
[234] Michaels (n 1) 364.
[235] Rahmatian, 'The Political Purpose' (n 10) 236. See the argument made earlier in a referred footnote.

harmonisation cuts across systems which are different, there is need to presume that systems are, in some ways, similar (i.e. functionally equivalent). It is therefore the idea of harmonisation that prompts the need for some presumption of similarity. Husa makes the same observation: that the presumption of similarity provides a rational tool for convergence of legal rules.[236]

Therefore, we can say that both EU directives and the functional method share the same principles on functional equivalence and the presumption of similarity. Does this mean that directives are functional instruments? The above suggests that they are. But one key element still missing in directives, which is endorsed by the functional method, is the idea of system-neutrality, that is, the idea that norms may be defined in a system-neutral way, in terms of their effects or function. We will consider whether this equally applies to directives below.

3.5 DIRECTIVES AND SYSTEM-NEUTRALITY

As seen in the previous chapter, Zweigert and Kötz argue that it is possible to define solutions or legal norms in a system-neutral way, outside their context. According to them, where function is ascertained, it must be cut loose from its conceptual context and stripped of its national doctrinal overtones so that it is seen purely in the light of its purpose to satisfy a legal need.[237] As suggested in the previous chapter, the reason why legal norms can be defined in a system-neutral way is because problems/solutions are presumed to be universal. Therefore, a focus on problem-solution as elements external to a specific legal system helps the functionalist to secure a neutral point of reference not contaminated by the national system.

Regarding EU directives, if we are to assume, as seen above, that directives are based on the presumption of functional equivalence which in turn rests on the presumption of similarity, does this not suppose that directives are system-neutral? After all the aim behind the presumption of similarity, as noted above, is to deduce a system-neutral definition of legal norms based on the similarities between systems.

There are other grounds to support the view that directives are system-neutral and apply the functional method. As suggested by both Doczekalska [238] and Stefaniak,[239] because of the multilingual nature of EU Member States, directives are drafted in 'neutral', generalised terms

[236] Husa, 'Much Ado' (n 1) 19.
[237] Zweigert and Kötz (n 6) 44.
[238] Doczekalska (n 154) 67.
[239] Stefaniak (n 154) 62.

which cuts across systems.[240] As will be argued below, although both authors consider this point from a drafting perspective, the idea behind such drafting is that the terms, in some ways, reflect something which is common to all systems.

3.5.1 Directives, drafting and system-neutrality

As noted above, both Doczekalska and Stefaniak suggest *inter alia* that because of the multilingual nature of EU Member States, directives are drafted in a system 'neutral', generalised way to accommodate the different systems. This suggests that the idea of system-neutrality is particularly an issue of drafting alone without reference to the concept. The question therefore is whether this is the case? Or rather, if it relates to the substantive concept? Or both the substantive concept and drafting?

It is important to note that Doczekalska and Stefaniak write from the perspective of the legal translation of EU legal texts, that is, the process whereby the drafting of EU legislation is translated from a source language into the various languages of the Member States. Technically, the idea of legal translation does not work well with EU legislative instruments, including directives. This is because the different language versions of EU legislation are all deemed to be equally authentic and have the same legal effect, [241] unlike normal translation processes whereby the source language take prominence than the target language. However, Stefaniak notes that the idea of translation indeed applies to EU legal texts since they are prepared in one source language and then translated into other languages.[242] According to Stefaniak, in a normal EU legislative procedure, legislations often starts from a Commission Proposal which is drafted in a single language. After consultation, the Proposal is then sent to the Directorate-General Translation who may improve the linguistic quality of the original text. Stefaniak notes that the text is translated only after consultation has been finalised on the original draft. After this, all the translations are sent to the Parliament and Council who work on the translations in parallel.[243] Furthermore, the Council's working groups, made up of Member States' experts, all have the text available in their language version. The Working Groups may subsequently make modifications which are then translated by the Council translators who also produce the language versions of the modified text.

[240] Doczekalska (n 154) 67; Stefaniak (n 154) 62.
[241] Case 283/81, Srl *CILFIT* (1982) ECR 3415, para 18; Agnieszka Doczekalska, 'Legal Multilingualism as a Right to Remain Unilingual: Fiction or Reality?' (2014) 20 Comparative Legilinguistics 1, 13; Stefaniak (n 154) 59.
[242] Doczekalska (n 154) 67.
[243] Stefaniak (n 154) 60.

This is then submitted to the Committee of Permanent Representatives and Council for political agreement. Importantly, Stefaniak notes that although the different language versions of EU legislative proposals or instruments are equally valid and have the same legal effects, from the perspective of the process involved, the language versions are produced by means of translation, since the translations are all obtained from one original source language.

In terms of the actual drafting of EU instruments, including directives, Stefaniak notes that they are drafted in a way to avoid reference to national terms, because of the multilingual nature of EU Member States. She notes that that ' there is tendency towards general rather than particular, and neutral rather than culturally marked [terms]'.[244] Thus, the result of having neutral terms is that such terms become 'hybrid' and 'situated at an intersection of cultures, being amalgamates of various linguistic and rhetorical features, blurring the boundaries between language and cultures'.[245]

The above will suggest that the issue of preparing EU legal texts, including directives, is not simply one of drafting but also relates to the substantive concepts. Doczekalska agrees with this. According to her, legal translation involves cultural transfer, and a legal translator should be knowledgeable about the concepts in both the source and target language. This aids the translator in identifying the difference between concepts and to ascertain if the concepts are equivalent. Therefore, for a legal translator to make appropriate decisions when choosing a term in a target language to denote a concept obtained from the source, a comparison is necessary between the source and target language legal concept. In Doczekalska's view, two terms are equivalent in translation studies when they have the same legal effects.[246]

Doczekalska similarly sees the preparation of EU legal texts as an activity of legal translation. According to her, the preparation of EU legal texts requires first the comparison of equivalent legal concepts between the national systems. Thus, the national concepts are compared with each other to see if they are equivalent, i.e. give rise to the same effect. After this, the equivalent terms are replaced with 'neutral terms (i.e. terms that are not specific to any national legal system) or neologisms'.[247] Primarily, similar to the point made by Stefaniak above, the idea of producing a system-neutral term suggests that the EU legal texts is drafted to accommodate the equivalent terms/concepts in the Member States. Importantly, the reason why the various concepts can be accommodated under a system-neutral meaning is because, as Doczekalska notes, they have the same legal effects or perform the same function.

[244] ibid 62.
[245] ibid.
[246] Doczekalska (n 154) 71.
[247] ibid 67.

The above raises the question as to the theoretical underpinning behind the idea of system-neutrality. The idea seems to share some resemblance with the functionalist presumption of similarity, which, as earlier noted, also has the primary objective of identifying an optimal provision that transcends national boundaries.

On the one hand, Doczekalska notes that for both the functional method and legal translation, response to the same social problem is the starting point. Thus, institutions are functionally equivalent in both fields when they respond to the same social problem.[248] Essentially, two conclusions can be drawn from this when seen within the context of system-neutrality in legal translation: First, as noted above, Doczekalska and Stefaniak both suggest that the idea of system-neutrality presupposes a legal concept accommodating the functionally equivalent concepts in the various systems. If that is the case, and it is also accepted, as Doczekalska does, that those different concepts are a response to the same social problem, then the necessary implication is that the idea of system-neutrality is likewise premised on the assumption that systems face the same social problems. In other words, because systems face the same social problem, it is therefore possible to identify a uniform concept. Secondly, because concepts are deemed to be functionally equivalent when they have the same legal effects, this also means that the idea of system-neutrality assumes similarity in terms of solutions/legal effects given by systems.

Importantly, the above suggests that the idea of system-neutrality in legal translation which is ascribed to EU directives are based on the presumption of similarity, that is, that solutions and problems are the same. Therefore, because of this similarity, it is possible, as Michaels notes, to define terms in a way which transcends the doctrinal peculiarities of the local national systems, based on what is common in the systems.[249] Within the context of the Collateral Directive, this is seen in the way in which the Directive defines a TTFCA and an SFCA. The assumption is that these definitions transcend the local national systems because of the presumption that there is an 'ideal feature' common to the concepts in the various system, or rather that they give rise to the same effects. If this is the case, it is then possible to identify the meaning of both definitions at the level of the Directive.

It is important to note that Doczekalska further argues that while legal translation has a terminological character, the functional method on the other hand does not focus on terminology but on legal regulations that resolve certain problems. In her view, the functionalist considers

[248] ibid 71.
[249] Michaels (n 1) 376.

language to be a barrier and instead seeks to facilitate a research conducted beyond language.[250] Thus, unlike the legal translator who is focused on identifying adequate terms, the functional method does not therefore have a terminological character.[251]

In making the above point, Doczekalska is not restricting legal translation to merely a question of drafting or terminology. As earlier noted, Doczekalska argues that translation is not possible without a focus on legal concepts and the context within which they operate. This implies that aside the terminological aspect, legal translation also studies legal concepts and institutions. However, Doczekalska seems to be saying that the functional method pays no attention to terminology, but rather focuses on social problems and legal concepts as a response to those problems. Insofar as 'terminology' embeds doctrinal differences in systems, they are considered to be an impediment to functionalist analysis. Importantly, this means that the idea of system-neutrality as an issue of drafting or terminology is less important to the functional method.

The above point raises a question in relation to the aim and scope of the functional method. As earlier observed, Michaels notes that the functional method is a tool for the harmonisation of laws. Thus, once similarities are identified, it becomes easier to formulate an optimal law which transcends national boundaries. Zweigert and Kötz similarly, as mentioned earlier, note that the method can be used as a tool for developing a system with special syntax and vocabulary large enough to embrace the quite heterogeneous legal institutions. Thus, the method is not just focused on the identification of social problems and solutions; it can also be used to build a system of concepts. This seemingly will refer to the development of terminologies or concepts to express *inter alia* a legal provision, aimed at harmonisation. Importantly, this suggests that terminology is one of the tools of the method, since such system-neutral norms will expectedly be contained in some legislative instruments, such as directives.

The above discussion points to the following conclusions: first, the concepts in directives are system-neutral. In this regard, they are deemed to transcend the doctrinal peculiarities of the national systems because of the presumption of similarity in terms of problems and the effects of legal rules. This conclusion, as discussed above, can be premised not just on the drafting of directives but also on the presuppositions behind the drafting. Therefore, the process through which the drafting emerges suggests that the core focus is whether institutions have the same legal effects or fulfil the same function. This is nothing but a functional approach.

[250] Doczekalska (n 154) 69.
[251] ibid 70.

3.6 CONCLUSION

The chapter has argued that EU directives adopt a functional approach. In summary, the reasons given for this position are: First, like the functional method, directives are broadly anti-doctrinal and define legal rules purposively in terms of their functional relation to a result. Secondly, the operation of directives is also premised on the presumption of similarity in terms of problems and solutions. Lastly, as seen above, similar to the functional method, directives are also system-neutral, that is, because legal concepts in the national systems have the same effects, there are presuppositions that the concepts or ideas in Directive are transsystemic.

While the previous chapter and this chapter consider the broader theoretical issues behind the functional method and its applications to EU directives generally, the remaining part of the thesis will focus on the last point above, that is, the supposed system-neutrality of the concepts in directives in terms of their effects, although references will be made to the other assumptions. The thesis will thus use the Collateral Directive to consider whether phrases and ideas such as 'full ownership', 'possession and control', 'by way of security', ownership of financial collateral, and the definition of TTFCA and SFCA, as collateral arrangements, are system-neutral.

However, before we examine these question, the next chapter will consider another broad issue which touches on both the TTFCA and SFCA: i.e. what is recharacterisation. As seen in the next chapter and in section 9.2, recharacterisation of a TTFCA will normally deal with what amounts to a security device (that is, an SFCA). The chapter therefore broadly provides a context for the issues considered, especially in chapters five, seven, eight and nine.

4 CHAPTER FOUR: RECHARACTERISATION AND TITLE TRANSFERS

4.1 INTRODUCTION

Over the past decade the use of financial collateral to support cross-border payment and securities transactions has expanded within the EU.[252] This remains the trend today as government debt, which is primarily issued in the form of treasury bills and bonds, continues to increase.[253] One of the features that make these instruments appealing to investors is their liquidity and the ability to use them as collateral. The use of these instruments as collateral is made possible under the various domestic laws of EU Member States which decide how proprietary interests can be taken over them.

Within the EU, the most favoured means of taking collateral was through the pledge.[254] Parties using a pledge had to comply with certain onerous conditions, such as publicity requirements [255] and other legal requirements which curtailed the power of secured creditors to use the assets or realise them in the event of default. These restrictions, especially the publicity and/or registration requirements, make the pledge less attractive to financial market participants who may rather opt for an outright transfer of title from the collateral provider to the collateral taker. This is because the publicity requirement in a transfer of title is often less onerous.[256]

In a title transfer what was needed was for the collateral provider to transfer ownership or entitlement in the collateral to the secured creditor for the purpose of securing the debt.[257] Because ownership is transferred outright, rather than a limited real right or security interest, the secured creditor is excused from the publicity requirements. [258]As owner, he can also freely

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[252] Geoffrey Yeowart and others, *Yeowart and Parsons on the Law of Financial Collateral* (Edward Elgar Publishing Limited 2016) para 1.31.

[253] ibid 1.04-1.06.

[254] European Financial Markets Lawyers Group (EFMLG), 'Proposal for an EU Directive on Collateralisation' (June, 2000), 7 <http://www.efmlg.org/Docs/Documents/2000%20June%20EFMLG%20Proposal%20for%20an%20EU%20Directive%20on%20Collateralisation.pdf> accessed 20 March 2016. In this chapter, pledge will refer to security devices in Member States, such as Dutch and German laws, through which a limited real right is created in an incorporeal moveable property. It is therefore not analogous to the pledge under both English and Scots laws which are possessory securities.

[255] A publicity requirement is imposed to bring property rights to the notice of third parties. There are different types of publicity requirements, such as registration (under the Companies Act 2006, part 25) possession or control, although it is arguable if 'control' is a publicity requirement, as will be considered in chapter ten.

[256] EFMLG, 'Proposal, 7-10.

[257] Yeowart and others (n 252) paras 6.06-6.08.

[258] As discussed in chapter seven, in Scots law the only way in which a security device can be created over financial collateral is a *fiducia cum creditore*. Such transfers must comply with the publicity rules

deal with the collateral. This collateral arrangement therefore offered flexibility to market participants, especially by allowing custodians or investment banks to use their clients' collateral in executing further transactions to generate income. However, the arrangement was not without its problems.

Other than under English law and Scots law,[259] a transfer of ownership for the purpose of temporarily securing a debt stood the chance of being recharacterised as a 'disguised pledge'. The effect was that the transaction was either treated as void [260] or that parties were made to comply with publicity requirements.[261] In systems where these effects were reached, the analysis of proprietary arrangement may start from the economic purpose of a transaction: that is, that anything entered for a security purpose is a security arrangement and should therefore be subject to the rules governing security devices. This is an example of the so-called risk of 'recharacterisation'[262] which arose in some Member States wherein the transfer of ownership to secure a financial obligation was not recognised but was instead struck down.

The Collateral Directive was enacted primarily to stop Member States from recharacterising a TTFCA, that is, to legitimise the arrangement.[263] As highlighted in chapter one, a TTFCA is defined in the Directive as an arrangement under which full ownership or full entitlement in financial collateral is transferred by the collateral provider to the collateral taker

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under the UK Companies Act 2006, part 25. A proposal has been made for a limited security. See Scottish Law Commission, *Report on Movable Transactions* (Scots law Comm No 249, 2017), vols 1-3. The position under both English law and German law may be different. Under English law, an outright transfer does not attract the publicity rules. Similarly, German law recognises a transfer of ownership for a security purpose over movables. This arrangement is not registerable and is thus 'secret'. Rahmatian, 'German and English Law' (n 8) 238; Sjef van Erp and Jan Smits, 'Personal and Real Security', *Elgar Encyclopaedia of Comparative Law* (2nd edn, Edward Elgar Publishing Limited 2012) 652; Joanna Benjamin, *Interests in Securities: A Proprietary Law Analysis of the International Securities Markets* (Oxford University Press 2000) para 6.03. (See Benjamin's text for the position in English law).

[259] Yeowart and others (n 252) 146. The risk of recharacterising a title transfer as a 'disguised pledge' does not arise in Scots law where the collateral are incorporeals. See the discussion in section 7.3.1 on this.

[260] Keijser (n 96) 124. This is seen, for example, under Dutch law where Article 3:84(3) of the Dutch Civil Code abolishes the fiduciary transfer of title for the purpose of security.

[261] European Financial Markets Lawyers Group (EFMLG), 'Statement on a Proposal for a Directive on Financial Collateral (Com (2001) 168)' (2001), 10 <http://www.efmlg.org/Docs/Documents/EFMLG%20Statement%20on%20a%20Proposal%20for%20a%20Directive%20on%20Financial%20Collateral%20Arrangements%20(COM(2001)%20168).pdf > accessed 15 August, 2016.

[262] The meaning of this term will be considered below.

[263] George Gretton, 'Financial Collateral and the Fundamentals of Secured Transactions' (2006) 10 Edin LR 209, 211. Gretton argues that a better name for the Directive may be the 'Repo Protection Directive'. A repo, or repurchase agreement, is an example of a TTFCA. Gretton argues that the Directive was enacted to apply a uniform rule in the European repo market by requiring Member States to recognise the terms of repos, instead of striking them down.

for the purpose of securing a relevant financial obligation.[264] Chapters seven and eight will consider this definition to ascertain if, as suggested by the functional method in the previous chapter, it is system-neutral: does it have the same effect in the various systems. However, this chapter examines the meaning of recharacterisation and, broadly, the approach behind the definition in the Directive. As suggested above, the Directive adopts a formal approach [265] which contrasts with systems which recharacterise a TTFCA because of its security function.

This chapter is organised into three sections. The first section explains what amounts to 'recharacterisation', which is the precursor to the provisions of the Directive on TTFCA. The second part examines the formalist/functionalist[266] divide and examines which category the definition of a TTFCA falls into. The last part considers title transfers broadly and what makes TTFCA in the Directive distinct from them.

4.2 WHAT AMOUNTS TO RECHARACTERISATION?

Recharacterisation is where a transaction is reformulated in a way that is different from how it was presented by the parties.[267] It is a 'process of rejecting attempts to evade the regulatory goals of a given form, such as judicially deeming certain contracts for sale of an [an asset] as mortgages'.[268] It generally arises where the terms of a contract are treated differently from that contemplated by the parties. The driver of recharacterisation may either be the court, as is often the case under English law, or may be legislation, for example under the Uniform Commercial Code of the United States.[269]

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[264] Collateral Directive, art 2(1)(b).

[265] Systems adopt either a functional or a formal approach. The Directive adopts the latter. However, it will be argued in chapters seven and eight that the Directive adopts a functional approach to identify a transaction and a formal approach in applying the legal consequences.

[266] It is important to distinguish the functional method of comparative law from the functional approach adopted in characterising secured transactions. Both share the same premise in that they both focus on results or function. However, within the context of this chapter, the term 'functional approach' mainly refers to the latter used in secured transactions.

[267] Alan Berg, 'Recharacterisation' (2001) 8 JIBFL 346.

[268] Nestor Davidson, 'Standardisation and Pluralism in Property Law' (2008) 61 Vanderbilt L.R 1598, 1648.

[269] The driver of (re)characterisation will be dependent on the extent to which legislation provides clear rules on property law. For example, under English law, there is no unified rule defining what a security interest is. The meaning is often dependent on 'judicial discretion' guided by previous cases. For this reason, it has been noted that what amounts to a security interest under English law is often 'blurr[y]' and difficult to pinpoint. See Gerard McCormack, *Registration of Company Charges* (3rd edn, Jordan Publishing Limited 2009) 13. The courts therefore play a major role in matters of (re)characterisation, especially devices which functionally perform a security purpose (i.e. retention of title clauses). However, it does not mean that legislation plays no part at all under English law. Legislation, such as the UK Companies Act,2006 provides for consequences where a proprietary device does not conform to form.

A typical recharacterisation process, for example, will be where a purported sale of an asset by way of receivables financing, or a reservation of title clause in a sale of goods transaction, is treated as creating a security right. Such transactions may be entered for the purpose of circumventing the publicity requirements which are mandatory for the constitution of security devices. Where the transaction is therefore recharacterised, the effect will be that a different set of rules apply, including the publicity requirement, which parties may have tried to circumvent. The transaction may be declared void or unenforceable against certain persons, for example, other secured creditors.

The example above qualifies as a 'normal recharacterisation' which takes place in proprietary analysis. In addition to this, recharacterisation may also arises under the sham rules.[270] The sham rules may have prefigured the 'normal recharacterisation', as systems, historically have had legal principles which prohibit certain actions.[271] Transactions which come under this rule create no rights for the law to give effect. Although contractual terms may have been executed by the parties, the transaction is treated as void. This is because the parties never intended to carry out the contract. An example is where the parties execute an agreement to transfer ownership in an asset to convince some creditor that such an asset no longer belongs to the debtor. The transaction may have been executed for the purpose of removing the asset from an insolvency procedure. Thus, there was never an intention to transfer ownership. This scenario arose in *Twyne's case* decided in England in 1601.[272] In that case, an English farmer sold his sheep to a friend. The sale was conducted after a writ had been served on the farmer. After the sale, the farmer remained in possession of the sheep. The parties

However, in contrast to English law, the Uniform Commercial Code (UCC) provides clear rules on what amounts to a security interest and the effect of failure to satisfy the requirements. For example, see ss. 1-201 (37) of the UCC which defines a security interest as 'an interest in personal property […] which secures payment or performance of an obligation'. This provision applies to any transaction insofar as the economic motive behind the transaction is to secure the performance of an obligation. The UCC is therefore the focal point of any analysis of what amounts to a security interest over personal property in US law.

[270] Under English law a 'sham' is defined 'as act done or documents executed by the parties […]which are intended by them to give to third parties or to the court the appearance of creating between the parties' legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create'. *Snook v London and West Riding Investments* (1967) 2 QB 786. Such transactions may later be recharacterised as a 'sham' or as a tactic to defraud creditors or remove assets from insolvency estate. This issue appears to arise in Civil law and Common law systems. Philip Wood, *Comparative Law of Security Interest and Title Finance* (2nd edn, Sweet & Maxwell Ltd 2007) 331.

[271] Nicholas Briggs, 'Sham Transactions'' (2003) 1 Insolvency Lawyer 27, 27–32. Briggs argues that in the case of insolvency, this type of transaction may be set aside under the Insolvency Act 1986, ss. 238 and 241(1)(d), as a fraudulent transaction at an undervalue or a transaction constituting a preference.

[272] *Twyne's case* (1601) 76 ER 809.

maintained during the trial that the sale was valid. The court, however, found the sale to be void on the ground that the right and obligations did not reflect the fact that a sale was conducted, and that the sale was entered to defraud the creditors who had served a writ on the farmer.

In the above case, the parties had executed a contract of sale, whether innocently (as claimed by them)[273] or fraudulently (as later ascertained by the court) to transfer ownership. However, the court found the contract to be void because there was never an intention to transfer ownership in the first place. The purpose was to remove the sheep from the reach of the farmer's creditors. The contract was therefore declared a nullity for this purpose, since such an arrangement was prohibited particularly under the *Fraudulent Conveyances Act* 1571.

It may be argued that the ideas in the above case historically prefigured the modern notion of recharacterisation. As noted, in that case the agreement was recharacterised from its original terms and treated as fictitious. This effect is similar to the modern idea of recharacterisation discussed below where the party's agreement may be requalified as giving rise to a different outcome. Essentially, the reconstitution of the party's arrangement as a sham is not different from the reconstitution of the party's agreement in the modern notion of recharacterisation.

In modern times, a normal recharacterisation process may arise where a purported sale of an asset, for example, by way of a reservation of title arrangement in a sale of goods transaction, is treated as creating a security right. Such transactions may be entered for the purpose of circumventing the publicity requirements. Where the transaction is therefore recharacterised, the effect will be that a different set of rules applies, including the publicity requirement, which parties may have tried to circumvent. The transaction is treated as unenforceable against certain persons, especially other (un)secured creditors and a liquidator.

A distinction can be made between the sham rule above and normal recharacterisation. The legal process involved in both will usually have an effect on the parties' contract: the contractual terms will be treated in a way different from what the parties contemplated, with a different set of rules applying. However, while the sham rule leads to stiffer effects (i.e. voidness of the agreement), 'normal recharacterisation' means that the transaction is simply not enforceable against third parties. As such, the underlying contract may still be valid between the parties themselves. Thus, normal recharacterisation will not be enforceable against

[273] ibid 815.

third parties. This is because there was no compliance with the publicity rules which puts third parties on notice of a real right.

In summary, we can conclude that: in the case of the sham rule, the arrangement is a nullity because there is nothing for the law to act on: the parties never intended the agreement to have effect anyway. Therefore, the law sees it as void *ab initio*. The contractual stipulations contained in the agreement, for which the law is concerned with, does not have any effect. On the other hand, a 'normal recharacterisation' creates rights and obligations. Although the contract may be treated as circumventing some statutory requirements, like the publicity requirements, the agreement creates rights and obligations which the law can enforce. This implies that the law protects the rights and obligations between the parties *inter se* which give rise to obligatory or personal rights, but does not protect the real right, because a condition to create the real right, i.e. publicity rule, was not complied with.

4.2.1 Formalism and functionalism as 'intent' and 'motive'

Characterisation of a TTFCA will often involve consideration of the question of what amounts to a security right, which we will consider in chapter nine. There are several approaches to this question, which may broadly be divided along the lines of 'motive' and 'intent', although those labels are important elements in criminal law in finding a person criminally responsible. Nevertheless, the idea behind them may be applied to the functional/formal divide.

In criminal law, motive may broadly be defined as the reason behind the doing of an act, while the intent refers to the purpose of doing something. This description may be clearer with an example: for instance, John may desire James' Rolex wristwatch (motive) and subsequently takes it into his custody permanently without James' permission (intent). The intent here, which criminal law is often concerned with, is to steal: James took the Rolex wristwatch with the intent of stealing it. This will normally be a requirement for criminal liability. The motive which is John's desire to have James' Rolex wristwatch, does not go the question of criminal liability. It may be an ethical question whether it is wrong to desire somebody else's wristwatch, but that desire/motive does not count towards the finding of criminal liability.

The difference between both ideas aligns with the functional/formal divide. The functional system considers the motive behind the transaction. In this sense, the focus is on the economic reason behind the transaction. Therefore, in the case of a TTFCA in the Directive, for instance, the primary motive is to secure an obligation. In a formal system, this motive is likewise present in a TTFCA. But the formal system, rather than consider the motive behind the TTFCA (to secure an obligation), considers the 'intent' which, ideally, is to bring about the legal consequences stipulated

by law. In other words, although the primary motive of the parties may have been to use the collateral to secure an obligation, the intent, which the law looks at, is whether those legal effects indeed arose.

This distinction therefore aligns with the formal/functional divide. On the one hand, some systems define proprietary arrangements based on the functional effect or the 'motive' behind a transaction. Other systems adopt an approach that looks at the 'intention' and legal consequences of a transaction. As noted, the first approach above (i.e. the functional approach) defines a proprietary arrangement based on the parties' motive to secure the performance of an obligation. It pays no attention to the legal consequences of such an arrangement as, for instance, when ownership is transferred to secure a debt. Rather, it considers the substance rather than the form of the transaction. [274] This approach is found mainly under Article 9 of the Uniform Commercial Code of the United States and the property law of some other legal systems such as Canada and New Zealand which have adopted the US approach.

The formal approach, on the other hand, defines proprietary devices based on their legal consequences. The approach preserves the distinction between ownership and security with the underlying assumption that they perform different functions. Goode argues that the formal approach is one which sharply distinguishes the grant of security from other title financing devices based on the location of ownership rather than the economic motive behind the transaction.[275] Therefore, in the case of a TTFCA or other title financing devices, instead of considering the 'motive' behind the transaction to secure a relevant obligation, the formal approach considers the intention to transfer ownership and the legal consequences which flow from the transfer of ownership. The approach is adopted in England and some Civil law systems such as the Netherlands and Germany.[276]

A distinction needs to be made between the internal contents of systems which adopt the formal approach (i.e. Common law and Civil law). In Civil law the principle of *numerus clausus* means that proprietary arrangements fall within a closed group and parties cannot 'deviate from the established patterns of right', including security rights or limited real rights.[277]

[274] Michael Bridge and others, 'Formalism, Functionalism and Understanding the Law of Secured Transactions' (1999) 44 McGill Law Journal pp 567-664.
[275] Louise Gullifer (ed), *Goode and Gullifer on Legal Problems of Credit and Security* (6th edn, Sweet & Maxwell Ltd 2017) para 1.04.
[276] ibid.
[277] Jan Dalhuisen, 'European Private Law Moving from a Closed to an Open System of Proprietary Rights' (2001) 5 Edin LR 273, 285.

On the other hand, in English law, although this idea of *numerus clausus* exists (in that there are specific types of real right),[278] proprietary analysis often starts from contractual terms and then to legal consequences. Contractual terms play an important role in proprietary law analysis.[279] Freedom of contract is seen as the 'default position in commercial contract unless there is some reason to qualify it ', as, for instance, where the contract has a third party effect.[280] In this regard, a balance needs to be struck between the parties' freedom to contract on one hand and the need to protect third parties on the other hand.[281] Finding this balance is always problematic especially for arrangements which are non-registerable under English law.[282] Because such arrangements are non-registerable, this gives rise to policy considerations, i.e. that may affect other creditors who may not be aware of their existence, even though the arrangements are in the form of security.[283] In the absence of any rules on registration of such devices, the courts often play an active part in 'determin [ing] the boundaries of [such] concepts on the basis of the damage done or not done' to third parties.[284] (Re) Characterisation[285] of such proprietary arrangements (e.g. title transfers and title retention devices) therefore forms an active part of proprietary analysis under English law as a policy means of shaping the boundaries of these type of arrangements.[286]

[278] Bram Akkermans, *The Principle of Numerus Clausus in European Property Law* (Intersentia 2008) 331.
[279] Hugh Beale and others, *The Law of Security and Title-Based Financing* (3rd edn, Oxford University Press 2018) para 4.01; Harry Sigman and Eva-Maria Kieninger (eds), *Cross-Border Security Over Receivables* (Sellier European Law Publishers 2009) 94–95.
[280] Louise Gullifer and Jennifer Payne, *Corporate Finance Law: Principles and Policy* (1st edn, Hart Publishing 2011) para 6.2.4.
[281] ibid 6.2.4.
[282] Generally, title transfers are not registerable, although they may perform a security function.
[283] Gullifer and Payne (n 280) para 6.2.4.
[284] ibid.
[285] See Beale and others (n 279) para 4.13. Beale defines characterisation as the 'process whereby the law decides whether a security interest or an absolute interest has been created by a particular transaction'. (Re) characterisation will often involve the question of registration under English law. As seen above, the reason for this is that many of the devices (e.g. retention of title or factoring) which give rise to (re)characterisation perform quasi-security functions and they are not registerable. Proposals have been made for their registration. For example, see Law Commission of England and Wales, *Consultation Paper on Registration of Security Interests: Company Charges and Property other than land* (Law Comm No 164,2002), paras 1.54-1.55 which contains proposal for a functional approach and registration of quasi-security devices
[286] As noted above, under English law, the courts are often the drivers of recharacterisation in the absence of any clear legislation. L. Gullifer and J. Payne argue that the 'better course may be express legislation to deal with the problem' or alternatively 'a reform of the registration requirements. Gullifer and Payne (n 280) para 6.2.4.

However, regarding TTFCA, there are English law authorities which provide that such an arrangement does not attract the risk of recharacterisation because it transfers an absolute interest.[287] In Civil law, however, this arrangement stood the risk of being recharacterised or nullified because they were not recognised under the laws of some Member States.

In summary, in English law, 'characterisation' by the court is prevalent. This partly is based on historical factors dealing with the way legal principles develop organically through the courts and the lack of *a priori* conceptualisation of legal concepts. However, a TTFCA does not attract the risk of 'recharacterisation' for the reason that it is recognised under English law. On the other hand, in some Civil law systems, recharacterisation risk may arise in particular regard to the TTFCA because of its lack of legitimisation. The transaction will therefore be treated as void. The Civil law effect will therefore closely resemble the consequences under the sham rule above whereby transactions are voided.

From the above discussion, it is apparent that the Collateral Directive is mainly concerned with systems in the EU which did not recognise the TTFCA and may invalidate it,[288] but this does not imply that the provisions on TTFCA, such as its definition is not equally directed at English or Scottish law or other systems which legitimise it. The discussion below will briefly examine the nature of TTFCA as a type of title financing. We will also briefly identify how the Collateral Directive casts the concept of TTFCA.

4.3 TTFCA AS A TYPE OF TITLE FINANCING

A TTFCA is a type of title financing. In the financial markets title financing is often associated with repurchase agreements (repo) [289] and securities lending.[290] Their recognition in

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[287] *Pearson v Lehman Brothers Finance SA* [2010] EWHC 2914 (Ch) 78–82; *Mills v Sportsdirect.com Retail Ltd* [2010] EWHC 1072 (Ch); *Beaconwood Securities Pty Ltd v ANZ Banking Group* [2008] FCA 594; Benjamin (n 258) para 6.55.

[288] EFMLG, 'Statement', 10.

[289] In a repo the buyer of the securities is the financier. He is the collateral taker. The transaction involves a transfer of securities from the collateral provider to the collateral taker in return for cash paid by the latter to the former. The transfer is made on the agreed condition that equivalent securities will be redelivered by the collateral taker, at a price paid by the collateral provider which equals the original purchase price plus an amount equal to the interest. Within the period that the agreement is still in place, there is the market risk that the securities may fall in value. To cover this risk, additional securities may be posted to cover any shortfall. Wood (n 270) 29.

[290] ibid. In securities lending, the seller of the securities is the financier in that he advances the securities to a counterparty. Since the borrower borrows the securities to sell to a third party, the transfer from the collateral provider must be outright. The transaction is usually carried out to enable a short-sell by the borrower. Once the time for redelivery approaches, the borrower must purchase equivalent securities to retransfer to the collateral provider. If the value of the collateral decreases compared to its original price, the collateral taker profits from that increase. The arrangement is often used for speculative reasons to take advantage of fluctuation in collateral prices.

the markets is traced to the United States where they were first adopted in financial transactions in the late 1920s.[291] Although English law has a long history of title financing,[292] the current form of title financing, in repurchase agreements and securities lending, was introduced into the United Kingdom in the mid-1980s. Other systems like Scotland, the Netherlands and Germany have functionally equivalent institutions in the form of *fiducia cum creditore* or other title-based financing devices such as the classical Civil law instalment sale, the resolutive condition subsequent in sale [293] and finance lease, under which the creditor either retains, takes or reserves the right to take title.[294] Functionally similar to the title financing devices under English law, these devices deal with the location of title as a means of covering the credit risk.

As highlighted in chapter one, the Directive defines a TTFCA as an arrangement, including a repurchase agreement, under which a collateral provider transfers full ownership of financial collateral to a collateral taker. This definition indicates that a TTFCA involves two key elements. The first, briefly discussed below, is that financial collateral is conveyed by way of a 'transfer'. Within the markets, this will often be achieved by way of a repo agreement or securities lending agreement. Secondly, the definition also indicates that the transfer is made for the purpose of conveying full ownership of , or full entitlement to, financial collateral.

A transfer refers to the transmission of an object from one party to another. It may denote the economic result of a transaction whereby the transferee acquires the asset which was previously held by another, the transferor. Whether or not the previous holder of the object was its original holder, a transfer will normally constitute a mode of 'derivative acquisition' of an asset, that is, the acquisition of an asset (financial collateral) previously held by the collateral provider, the transferor. [295]

For an arrangement to qualify as a TTFCA under the Directive, the transfer must be outright.[296] This requirement must be met even though the purpose of the transfer is to secure

[291] Michael Legg, 'Lending' Agreement Transfers Legal Title to Securities'' (2008) 231 Company Law Newsletter 1, 3. It was first recognised by the US court in *Provost v United States* (1926) 269 US 443.
[292] For e.g. hire-purchase recognised in 1895 in *Helby v Matthews* [1895] AC 471; sale and leaseback, factoring and forfeiting, securitisation, finance leasing.
[293] In Scotland, such conditions have no proprietary effect.
[294] Bridge and others (n 274) 653.
[295] Christian von Bar and Eric Clive (eds), *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR),* vol 5 (Oxford University Press 2010) 205; Benjamin (n 258) 3.02.
[296] Keijser (n 96) 16–18. The market documentation on title transfer is also clear that what is contemplated is an outright transfer. See clause 6 of GMRA on 'Payment and Transfer' and clause 2.3 of GMSLA on 'Market Terminology'.

an obligation. What is meant by an outright transfer is that the transfer must be made without the collateral provider retaining any residual interest in the asset. Broadly, failure to comply with the above attracts the risk of recharacterisation. The arrangement may be treated as an SFCA and therefore be treated as void or subject to the publicity requirements.

As highlighted above, other than the 'transfer' requirement, a collateral provider in a TTFCA must also transfer ownership. We will briefly consider the definition of financial collateral below before considering what it means to have full ownership in the next chapter.

4.3.1 OBJECT(S) OF TTFCA: CASH, FINANCIAL INSTRUMENTS AND CREDIT CLAIMS

The Collateral Directive provides that financial collateral consists of cash, financial instruments and credit claims.[297] Cash is defined as money credited to an account in any currency or similar claims for the repayment of money, including money market deposits. It will include a deposit or credit balance held with a bank by a customer [298] but will not include banknotes.[299] The use of the term 'repayment' does not necessarily mean that there must be a borrower/lender relationship. However, the term may generally be read to mean a relationship of debtor/creditor under which certain sums are liable to be repaid.[300] It has also been argued that cash cannot refer to all claims for the repayment of money because, if that is the case, the addition of credit claims as financial collateral would not have been necessary.[301]

Credit claims, on the other hand, are pecuniary claims which also give rise to repayment obligations. The obligations usually arise out of an agreement whereby a credit institution grants loan or credit to consumers or businesses.[302] An example of a credit claim will be loans granted by banks. The Collateral Directive provides that these loans may be used as collateral under a TTFCA.

Financial instruments also constitute financial collateral. They are defined as shares in a company and bonds and other forms of debt instruments if these are negotiable on the capital markets.[303] Shares in a company will normally vest in the shareholder certain rights, such as

[297] Collateral Directive, art 4(a). A credit claim was added in 2009 by the EC to serve as an alternative to securitisation. Yeowart and others (n 252) 51.
[298] ibid.
[299] Collateral Directive, recital 18.
[300] Yeowart and others (n 252) 51.
[301] Look Chan Ho, 'The Financial Collateral Directive's Practice in England' (2011) 26 JIBLR 151, 156.
[302] Yeowart and others (n 252) 69.
[303] Collateral Directive, article 2(1) (e).

the right to income and to participate in the distribution of a company's assets in insolvency. Bonds on the other hand will refer to debt instruments issued by corporate entities or governments with a contractual obligation to pay certain sums within a period.

One feature similar in these three items (cash, credit claims and financial instruments) is that they give rise to personal rights. Although they may have books in which they are physically or electronically recorded, their value is found not in the electronic document itself, but in the right of performance or forbearance due from the debtor or from the company. This is what makes them valuable within the financial markets (and the Collateral Directive).[304] In the case of debt, the obligation by the debtor to discharge the outstanding obligation is what makes it valuable. For financial instruments, such as company shares, their value is also found in the performance of some obligations by the company, for example, the payment of a dividend.

In summary, cash, financial instruments and credit claims give rise to personal rights. As noted, it is some of these rights that constitute assets which are the objects of transfer in a TTFCA. As will further be elaborated in chapter six, conceptually there is no difference between these assets: they are all claims, or choses in action.

In addition to the above, the Directive further provides that a TTFCA is completed upon the transfer of full ownership of financial collateral. There is a question as to whether the adjective 'full' adds anything to whether a person has ownership or not. A person either has ownership (even where there is a subordinate real right in the right) or does not. He cannot have part ownership. In any event, the relevant question is how can this term be understood in systems, like English law, where property rights, in a trust, are fragmented between a beneficiary and trustee. [305] Similarly, in Scots law, a case could also be made that a Scottish trustee has full ownership while the beneficiaries, who may be investors in an intermediated structure, merely have personal rights.[306] How, then, is the idea of full ownership to be understood, especially, in context of the beneficiary's right in Scots law? These questions will be considered in the next chapter.

[304] Wolfgang Mincke, 'Property: Assets or Power? Objects or Relations as Substrata of Property Rights' in JW Harris (ed), *Property Problems: From Genes to Pension Funds* (Kluwer law International) 86, that is accepting Mincke's argument that the 'value of obligation is created when the parties enter into the contract; it disappears with performance'.
[305] Under English law the concept has been said to be 'the most elusive'. Ewan McKendrick (ed), *Goode on Commercial Law* (5th edn, Penguin 2016) 34.
[306] George Gretton, 'Trusts without Equity' (2000) 49 Int'l & Comp LQ 599, 612.

Another problem with the definition of a TTFCA is that it presupposes that financial collateral (incorporeals) can be the object of ownership or a real right. This is also a controversial issue which will be considered in chapter six.[307]

4.4 CONCLUSION

The chapter provides some context for the discussions in the subsequent chapters on the TTFCA and SFCA. First, it demonstrates that the primary purpose behind the Collateral Directive is to legitimise the TTFCA. This is in response to the risk of recharacterisation which was present in some systems where the arrangement was struck down as void, because it was functionally a security device. As discussed, in characterising a TTFCA, two approaches can be identified: the formal and functional. Where the latter is adopted, the effect is that the TTFCA is recharacterised with some attendant consequences: first, it may be requalified as a security device (SFCA) and declared unenforceable against third parties because the third parties will normally be unaware of the rights. Secondly, in some other cases, such as in Dutch law before 1992 (as will be discussed in chapter seven), the transaction may likewise be a security device but declared void, rather than unenforceable. Alternatively, there are legal systems where a TTFCA is recognised as valid. Those systems generally adopt a formal approach and will not characterise the transaction based on its effect or the 'motive' of the parties. The Collateral Directive adopts this latter approach, with the effect that the transaction is to be treated, in terms of the drafting of the Directive, as a transfer of full ownership for a security purpose, rather than as an SFCA. But what does the term 'full ownership' mean, most especially in English law where property rights are thought to be relative? The next chapter considers this question.

[307] George Gretton, 'Ownership and Its Objects' (2007) 71 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 802, 802–851; Kenneth Reid, 'Obligations and Property: Exploring the Border' [1997] *Acta Juridica* , 225–245. This issue also arises in English law: John Tarrant, 'Obligations as Property'' (2011) 34 UNSWLR, 677–695; Geoffrey Samuel, 'Property Notions in the Law of Obligations' (1994) 53 Cambridge LJ 524; Tony Honoré, 'Property and Ownership: Marginal Comments' in Timothy Endicott, Joshua Getzler and Edwin Peel (eds), *Properties of Law: Essays in Honour of Jim Harris* (OUP 2006) 133.

PART B

5 CHAPTER FIVE: FULL OWNERSHIP IN THE DIRECTIVE: BENEFICIAL INTEREST AS FRAGMENTED OWNERSHIP

5.1 INTRODUCTION

As discussed in the previous chapter, the Collateral Directive defines a TTFCA as an arrangement under which full ownership, or full entitlement,[308] of financial collateral is transferred. It may be thought that this definition would be cast in a way which made the concept recognisable within the laws of Member States, that is, that the concept of full ownership should be one that every system recognises, because it is deemed to be system-neutral. As noted in chapter two, although the phrase full ownership literally is a doctrinal concept, the presupposition in the Directive is that, at least, there are institutions in Member States which have equivalent effects. Besides, to say that the idea of ownership is system-neutral, as the Directive presupposes, is not new. For example, as seen below, Rahmatian, writing from a functional perspective, argues that 'legal systems generally do not differ much in professing the extensive nature of ownership [….]' [309] His view especially from the perspective of English law, is founded on Honoré's definition,[310] discussed below, which he suggests is similar to the idea of ownership in Civil law.[311] Thus, this suggests that the use of the phrase 'full ownership' in the Directive is system-neutral in the same way that it is used by Rahmatian.

However, the question in this chapter is whether this presupposition in the Directive is accurate. The discussions in this section will therefore focus on ownership, highlighting its treatment in Civil law and Common law . In relation to Civil law, reference will be made to both Scots law and German law to highlight the persistence of the Civil law ownership concept.

[308] The concept of 'full entitlement' will be examined in the next chapter, since the phrase is used in the Directive in relation to systems (i.e. German law) that do not recognise that financial collateral are objects of ownership. Thus, it is used in relation to objects of real rights, rather than in relation to whether those systems recognise a concept of ownership. See European Commission, 'Proposal for a Directive of the European Parliament and of the Council amending Directive 98/26/EC on Settlement Finality and Directive 2002/47/EC on Financial Collateral' COM (2008) 213 Final para 6.2.2 (Proposal for amendment), where the EC explained that 'full entitlement' was included to distinguish 'ownership' of cash and financial instruments on the one hand and 'entitlement' to credit claims on the other hand.
[309] Rahmatian, 'German and English Law' (n 8) 211; Andreas Rahmatian, *Copyright and Creativity: The Making of Property Rights in Creative Works* (Edward Elgar 2011) 7–8.
[310] Honoré (n 18) 107–147; Marcus Smith and Nico Leslie, *The Law of Assignment* (2nd ed, Oxford University Press 2013) para 2.39; Michael Bridge and others (eds), *The Law of Personal Property* (2nd edn, Sweet & Maxwell Ltd 2017) para 2.006.
[311] Rahmatian, 'German and English Law' (n 8) 211. Although Rahmatian compares English law and German law, the definition of ownership in German law is not different from the civilian definition.

However, the chapter will focus more on English law, since it is a controversial issue whether English law recognises the concept of ownership.

Importantly, this question will be seen in the light of the broader debate on the functional method. As discussed in chapter two, one of the principal assumptions of the functional method is that it disregards the doctrinal context of legal institutions. Although it acknowledges that institutions have a context within which they function, the method does not treat context as important. The reason for this, as noted in chapter two, is that the method arose from a deliberate attempt to reject the earlier contextual study of law.

The discussion below takes the opposite direction by focusing on the doctrinal context of the concept of ownership, most especially in English law. However, the purpose of adopting this approach is not to pre-empt an answer to the above issue, but to demonstrate how particular effects or consequences can only be seen within their doctrinal context.

The conclusion in this chapter, as already suggested, is that the doctrinal context plays a part in how systems understand the nature of these concepts. We cannot define the concept based on particular effects or rights, which ,in some instances, are not the same. Those effects can only be seen within a broader context which gives them meaning. Moreover, using one concept (ownership) to compare with another (Common law property rights) may hide a latent subjective bias for the Civil law ownership right.

5.2 OWNERSHIP: CIVIL AND ENGLISH LAW

5.3 Ownership of Movables and Personal Property

The discussion below focuses on ownership as it relates to movables under Scots and German law, and personal property under English law. On the one hand, in Civil law systems, the classification of things is based on the nature of the *res* itself, rather than on the rights which may be had in the thing. Thus, on this basis, there is a division between things into immovable (such as land and buildings) and movables. Scots and German law retain this classification, although Scots law refers to immovable property as heritable property.[312]

[312] Before the Succession (Scotland) Act 1964, heritable property was property inherited by the heir. The term 'heritable', however, has been retained to refer to immovable property. Heritable property may be in incorporeal form, such as servitude, when it relates to an object linked to land. See *The Laws of Scotland: Stair Memorial Encyclopaedia*, Vol 18, para. 3. It is important to note that rights which have a 'tract of future time' are held to be heritable even though they may be personal or moveable. An example is a liferent right assigned to an heir in succession.

In English law, the division derives from the action by which the interest in things was enforced.[313] This procedure arose in the Middle Ages, when the common law allowed the so-called *real actions* which meant that land could be recovered where the proprietor of the freehold interest was wrongfully dispossessed. [314] As such, land was classified as real property or *realty*.[315] This can be contrasted from other actions to protect an interest which were qualified as *personal.*[316] This latter category did not entail a recovery of the *res* itself. Rather the claimant had a claim personally against the defendant. The things to which personal actions could be brought were described as personal property, or *personalty*.[317]

However, in English law, personalty can further be divided into chattels real and chattels personal.[318] The former consists of leasehold interests in land and, like other personal property, could be vindicated by personal rather than real action. Since 1925, leasehold interests in land are formally recognised as equivalent to other interests in land similar to the fee simple.[319] On the other hand, chattels personal are items of property that are not chattel real.[320] However, the terminology, chattel personal, is no longer important in modern times, except to denote its historical link to the further division of chattel personal into choses in possession (or 'things in possession')[321] and *choses in action* ('things in action'), respectively.

Things in possession are corporeal things like a phone or car, which can be claimed by physical possession. On the other hand, things in action signify property which can be vindicated by way of legal action rather than possession. Hence, for this reason, intangibles cannot be the subject of a claim in conversion since any claim founded on conversion depends on possession or right to immediate possession.[322] Comparatively, what English law may regard as personalty may be immovable property in Civil law. Thus, for example, a debt secured on land is immovable in Civil law, but personalty in English law.[323]

The treatment of these types of property objects have historically been different under English, Scots and German law, although from the 19th century, the system in Germany appears

[313] MG Bridge, *Personal Property Law* (Fourth edition, Oxford University Press 2015) 11.
[314] ibid.
[315] Smith and Leslie (n 310) para 2.50.
[316] ibid 2.50.
[317] Bridge (n 313) 12; Smith and Leslie (n 310) para 2.50.
[318] Bridge (n 313) 12.
[319] ibid. See also Law of Property 1925, s.1.
[320] ibid.
[321] Sarah Worthington, *Equity* (2nd edn, OUP) 59.
[322] Bridge (n 313) 15.
[323] *Re Hoyles* (1911) 1 Ch 179 185–87 (CA).

to have been codified to adopt a unitary system. Under English law, interests in land are governed by the doctrine of Estates. Personal property however is not subject to this, but are governed by specific rules under common law and equity.[324] This has led Fox, for example, to argue that there is a concept of unitary ownership in relation to personal property, particularly choses in action. [325] On the other hand, for 'much of its history, property law in Scotland was feudal law and little more'.[326] Feudalism inhibited the development of a general principle of ownership applicable to both heritable property and movables. However, movable property has, during feudalism and after its abolition,[327] been influenced by Roman law and the concept of *dominium* which has been retained under Scots law.[328] The abolition of the feudal system brought about an assimilation of the laws governing both heritable property and movables.

Similarly, in Germany, the *Corpus Iuris Civilis*, which is the foundation of codified Roman law, has also had an influence on the reception of the concept of *dominium* in German law.[329] Ownership is unitary, but the question whether it applies to incorporeal movable property is controversial under German law, as well as under Scots law, as discussed in chapter six.[330]

The discussion below will therefore focus on the concept of ownership particularly related to personal property under English law and movables under Scots and German property law.

5.3.1 Ownership in Scots and German property law

German property law recognises a concept of absolute ownership (*Eigentum).* § 903 of the *Burgerliches Gesetzbuch* (German Civil Code) provides that the owner of a thing may, to the extent that a statute or third-party rights do not conflict with this, deal with the thing at his discretion and exclude others from every influence. German law distinguishes the positive and negative sides of this power vested in the owner. The positive side refers to the power of the owner to deal with the asset as he deems fit. However, the powers are not unlimited. They may

[324] Bridge and others (n 310) para 1.039.
[325] David Fox, 'Relativity of Title at Law and in Equity' (2006) 65 Cambridge LJ 330.
[326] Kenneth Reid, 'Property Law: Sources and Doctrine' in Reinhard Zimmermann and Kenneth Reid (eds), *A History of Private Law in Scotland* (OUP 2000) 185.
[327] In 2004, by Abolition of Feudal Tenure, etc. (Scotland) Act 2000.
[328] Reid (n 326) 192.
[329] Barry Nicholas, *An Introduction to Roman Law* (OUP 1962) 52.
[330] Sjef van Erp and Bram Akkermans (eds), *Cases, Materials and Text on Property Law* (Hart Publishing 2012) 365–384; under Scots law, see Gretton, 'Ownership and Its Objects' (n 307) 805–851; Reid (n 307) 225–245.

be restricted by law, for example, where the exercise of the power affects others negatively or causes public harm. The negative side of the power refers to the power to exclude everyone from the use and enjoyment of the property. Together these powers confer on the owner an absolute right in the object.[331]

German law, in § 985 of *Burgerliches Gesetzbuch*, provides for the remedy of *vindicatio*. The provision provides that 'the owner can claim the return of the object from the possessor'. Pursuant to this provision, the owner may exercise his absolute right to the asset by claiming its return against the holder of the object or a subsequent holder.

Scots property law similarly has a concept of absolute ownership. In Scots law, ownership is defined as the 'right of using and disposing of a subject, except insofar as […] restrained by law or paction'.[332] Reid notes that this definition is traced to the institutional writer, Erskine who may have seen Sir George Mackenzie's definition in his Institutions of the Law of Scotland published in 1688. Mackenzie defines ownership in similar terms.[333]

Under Scots property law, ownership is defined as the principal real right and the most comprehensive right that can be had in an object.[334] Scots property law also treats ownership as absolute in the sense that it is not a relative right, that is, that it has an *erga omnes* effect. Ownership is a unitary concept, which means that the right of ownership is not divisible. However, it is arguable whether Scots law has the remedy of *vindicatio* in view of the controversy surrounding the classification of the remedy and the underlying rights on which it is based. [335]

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[331] Erp and Akkermans (n 330) 213–215.
[332] J. Erskine, An Institute of the Law of Scotland, Book II, 1,1.
[333] Reid (n 326) 198. As 'the power of using and disposing of what is ours, except in so far as we are restrained by law or paction'. Reid notes that Erskine's definition is 'stock definition' of the *Ius Commune*.
[334] George Gretton and Andrew Steven, *Property, Trust and Succession* (2nd edn, Bloomsbury Professional 2013) 27.
[335] David Carey-Miller, *Corporeal Moveables in Scots Law* (1st edn, W Green 1991) 171–187. Carey-Miller notes that the remedy was recognised by Scots law Institutional writer (Erskine). However, modern writers use alternative terms such as 'restitution' or 'action for delivery' to supplant the label of vindication. Carey-Miller notes that this is not 'simply a semantic issue' but one which has implications regarding the nature of the right resulting to the remedy. The modern preference to use 'restitution' instead of vindication is traced to Stair, who differentiates between the remedy of vindication from restitution. According to Stair, the right of vindication had a limited effect as it encompasses only the owner's right to recover the thing. It was a real right. However, it did not have the effect of imposing an obligation on the taker to return the object. Stair notes that it is the obligation of restitution which was the core of the basis of the right to recover possession of property. This right will be based on a personal right against the possessor. Carey-Miller criticises Stair's differentiation on the basis of 'artificiality', as it is implicit, when seen from Hohfeldian analysis, that a right gives rise to

Although Scots law, as seen above, recognises a unitary concept of ownership, there is a question of how this operates practically in the financial markets for securities held through intermediaries. The lower tier intermediaries, in Scots law, are deemed to have beneficial interest in the collateral. The question is how this interest may be accommodated within the framework of the unitary concept of ownership in Scots law.

5.3.2 Scots law: ownership in intermediated securities

In the case of registered shares (which are incorporeal moveables in Scots law), the shareholder often maintains a direct relationship with the issuer (and the share). However, for securities held through intermediaries, the ultimate investor has no direct relationship with the issuer or the security. There could be chains of intermediaries, as will be described below, which may typically involve layers of institutions. Because of these layers, the direct link with the share is missing. This situation is made more complex by the fact that all the intermediaries in the chain lay claim to the 'same' incorporeal asset issued by the same entity. [336]

A typical multi-tiered holding will normally have the following structure:[337]

a. The top-tier will consist of a central securities depositary (CSD) or an international central securities depositary (ICSID), which holds securities through a nominee. This top-tier intermediary maintains a direct relationship with the issuer (i.e. is registered with the issuer).
b. The second-tier will consist of institutions which hold accounts with the CSD or ICSID. Such accounts may be maintained for the institution's own benefit or for the benefit of their client (or for both themselves and their clients). The account may be 'allocated' (or segregated) or unallocated (commingled). For allocated, the securities are earmarked to particular participants so that it is easy to match the investors with the number of shares held by them. In unallocated or commingled accounts, the interests of the participants are pooled together without any

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a corresponding duty to return the item. However, he concludes that irrespective of the position one takes, it is not in doubt that Scots law recognises the 'real right' of an owner to recover his property. It is a real right because it avails against everyone 'who holds without a right to which the owner is subject'.

[336] Benjamin (n 258) para 1.107. Benjamin argues that the collateral is the same in 'economic terms', but they are different in conceptual terms. The lower tier intermediaries have an 'interest in securities', while the CSD has the underlying securities. She argues that interests in securities, unlike normal securities are always intangible, while the underlying securities may be tangible (bearer) or intangible (registered).

[337] For a discussion of the structure, see: Yeowart and others (n 252) 515–516; Louise Gullifer, 'Ownership of Securities: The Practical Problems Caused by Intermediation'' in Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities: Legal Problems and Practical Issues* (Hart Publishing 2010) 233; Louise Gullifer, 'Protection of Investors in Intermediated Securities' in John Armour and Jennifer Payne (eds), *Rationality in Company Law Essays in Honour of DD Prentice* (Hart Publishing 2009) 233.

designation as to their separate interest. These type of accounts may also be maintained by the intermediaries in each tier.

c. The third-tier will consist of direct clients of the participants above, who also maintain security accounts in their own books, recording the interest in the securities held for themselves, as well as those for its own clients.
d. There may be fourth and subsequent tier intermediaries who may have clients with accounts. Such intermediaries may also have securities held for their own benefit. This structure may continue till the ultimate investor who may be a private investor or broker for other clients.

The lower-tier intermediaries will all be account holders as well as account providers. However, the first-tier intermediary has a direct relationship with the issuer of the securities and is merely an account provider. This structure may arise for securities issued globally or domestically with CREST in the UK. However, CREST maintains a direct system and does not have a direct relationship with the issuer; that is, it only acts as an operator to conduct the electronic transactions. However, parties who accept a participation in the CREST system, either as users or sponsors, will normally hold securities for themselves and for others down a chain which results in similar intermediated structures as stated above.

This multi-tiered system is made possible by two factors: dematerialisation and the immobilisation of securities. Traditionally, securities were issued in certificated form. Dematerialisation brought about the issuance of securities in uncertificated and electronic form. It did not affect the relationship between the issuer and the investor, but only meant that securities are issued in an electronic format. On the other hand, immobilisation of securities logically leads to an indirect holding, since it requires the placement of a certificate of an entire issue of a bearer certificate with a depositary. The depositary may then be registered with the issuer and has physical custody, or possession, of the securities. The logical step after immobilisation is dematerialisation, since there needs to be dealings on such securities which may then be transacted through the intermediary structure above.

Since it is only the first-tier intermediary which may have a direct link with the securities, the question arises regarding the nature of the interests of the lower-tier intermediaries in Scots law, and whether this amounts to ownership under the Directive.

It is noted that the Scots law treatment of this issue is 'straightforward'. [338] An intermediated security structure takes the form of a Scottish trust.[339] Under such an arrangement the registered holder with CREST is considered to have ownership of the shares. The lower-tier intermediaries all have personal rights, as beneficiaries, in respect of those shares. The first-tier intermediary (trustee), being the shareholder, exercises all the rights in respect of the securities. On the other hand, the beneficiary has ownership of the personal rights which is a right against the trustee. As the Scottish Law Commission notes, the beneficiary can deal with the personal right against the intermediary as collateral.

Conceptually, Scots law adopts the idea of trusts and multiple patrimonies for this structure.[340] Although the principle under Scots law is 'one person, one patrimony',[341] some qualification may be made in this regard. In addition to a person's ordinary patrimony, a person may have a special patrimony. Therefore, the trustee, in an intermediated structure, has an ordinary patrimony containing his personal assets. In addition to this, he also has a trust patrimony containing the trust asset (collateral) which is a separate patrimony. The beneficiary, on his part, has his own patrimony. The beneficiary's personal right against the trustee is contained in its patrimony.

At each level of intermediation, the beneficiary has personal rights against the trustee above it who holds the trust object (financial collateral) on its behalf. As noted, the beneficiary has ownership of the personal right, and can arguably exercise all the rights vested in an owner with respect of such right: he may deal with it freely by assigning it to another person or use it or dispose of it or create a security right.[342]

However, the question arises regarding whether the beneficiary's right, at each level of intermediation, qualifies as financial collateral, especially financial instruments which are normally the objects in such structures. Article 2 (1) (e) of the Directive defines financial instruments as:

> [S]hares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital

[338] Scottish Law Commission, *Discussion Paper on Movable Transactions* (Scot Law Com No 151, 2011) , para 7.15.
[339] Yeowart and others (n 252) 687–288; Ben McFarlane and Robert Stevens, 'Interests in Securities: Practical Problems and Conceptual Solutions' in Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities: Legal Problems and Practical Issues* (Hart Publishing 2010) 58.
[340] See the idea of trust and multiple patrimonies in Gretton, 'Trusts without Equity' (n 306) 599–620.
[341] ibid 609.
[342] This analysis works if it is accepted that personal rights are valid ownership objects. This is controversial as considered in the next chapter.

> market […] including […] claims relating to or rights in or in respect of any of the foregoing.

The beneficiary's right may fall within the last phrase in the definition 'claims relating to or rights in or in respect of the financial instruments'. The phrase suggests that the right must either be directly linked and arising from the financial instruments or must be in respect of it. It is questionable if the beneficiary's right falls within the first requirement (relating to) since it has no direct claims to the collateral but only against the trustee.[343] However, the beneficiary right may fall within the second description (in respect of) if it is taken that its claims against the trustee is generally in respect of the trust property (the financial instruments).

This idea of trust and multiple patrimonies therefore makes it possible for the beneficiary to have ownership of the personal right, while the trustee has ownership over the securities themselves. Although this uses the trust concept, the idea of separate patrimony and ownership of personal rights means that there is no fragmentation of rights and that the concept of ownership is present, in line with the Collateral Directive.

However, there may be objections regarding the above analysis, which will be discussed in the next chapter. If, as discussed, the beneficiary has ownership of the personal rights, does it mean that Scots property law recognises the idea that claims can be the object of ownership? What will be the consequences if it is does not? As will be discussed, the next chapter does not exclude the fact that claims can be the object of ownership. This is because the question of what objects can be the object of a real right is system-dependent. Besides, there are scholarly views in Scots law which affirm the idea that rights can be the object of ownership.[344] Moreover, the fact that the Scottish Law Commission endorses the view that a beneficiary has ownership of collateral (i.e. personal right) in the lower tier intermediaries suggests that this view has weight within Scots law.

5.3.3 Civil law ownership as full ownership

Both Scots and German law recognise the concept of ownership. This means that it is not difficult to locate institutions which perform the function of 'full ownership' as provided in the Collateral Directive. Scots law, as discussed above, further shows its commitment to this concept even for intermediated securities and how the rights of the parties are structured. As

[343] George Gretton, 'Constructive Trust I' (1997) 1 Edin LR 281, 291:Gretton notes that in a constructive trust the beneficiary has rights against the trustee in respect of the assets. This idea (real subrogation) also applies to normal trusts.
[344] Kenneth Reid and others, *The Law of Property in Scotland* (Butterworths Law 1996) para 11; Reid (n 307) 225–245.

will be seen below, these views are noticeably different from the position in English law. Before we consider the English law position, it is important to note that although the Directive uses the term 'full ownership', the closest equivalent of this term in English law are the common law possessory right and beneficial interest. Thus, we will consider, in the section below, whether these two legal institutions qualify as full ownership as provided in the Directive.

5.4 FULL OWNERSHIP UNDER ENGLISH LAW

5.4.1 Ownership as priority of entitlement

In *Waverly Borough Council v Fletcher*,[345] the English court summarised the position in English law: that the 'English law of ownership and possession, unlike that of Roman law, is not a system for identifying absolute entitlement, but of priority of entitlement'. This conclusion has been repeated when discussing the concept of ownership under English law.[346]

As seen below, this case summarises the position under English law when discussing the concept of ownership. English law has two institutions which determine real rights in assets: common law and equity. The two debates which highlight this controversy will be examined below in line with this division. The first arises as a result of the recognition accorded a party in possession of property in common law. He is seen as the owner except against a party with the best possessory right. His ownership right in the asset competes with the rights of another who may likely have a better title to possession – title is relative.

The second debate relates to the institution of the trust and beneficial ownership in equity. The question which arises in regard to this is whether beneficial interest gives rise to a right in *rem* or in *personam*. However, before discussing this debate, it is important to point out that under English law the term 'ownership' is not a term of art referring to a specific concept which has certain consequences as a fundamental policy commitment.[347] The term appears to be used loosely and is often synonymous with 'title'.[348]

[345] [1996] QB 334, 345.
[346] James Gordley and Ugo Mattei, 'Protecting Possession' (1996) 44 Am J Comp Law 293, 303; Bridge (n 313) 44; William Swadling, 'Ignorance and Unjust Enrichment: The Problem of Title' (2008) 28 Oxford J Legal Stud 627, 641.
[347] Swadling, 'Ignorance and Unjust Enrichment' (n 346) 640.
[348] ibid.

However, there is some support for the idea of ownership in English law. Both Bridge *et al* [349] and Rahmatian [350] put up a strong defence for the recognition of the concept. What draws these two scholars together is that they refer, with approval, to Honoré's definition on ownership.[351] Notably, Honoré defines ownership 'as the greatest possible interest in a thing which a mature system of law recognises'.[352] He goes on to discuss the standard incidents of ownership which, in his view, 'do not vary from system to system […] but have a tendency to remain constant from place to place'.[353] These incidents include the right of possession, right to use and manage the assets; right to income and capital; protection from appropriation; transmissibility of the asset; absence of term; liability to execution and incidence of residuarity.[354]

Referring to Honoré's definition above, Rahmatian argues that legal systems, including English law, do not differ much in professing the extensive nature of ownership.[355] According to Rahmatian, the substance of the real right of ownership in systems can be split into attributes which convert the real right of ownership into an internal and external side, which are two sides of the same coin.[356] The internal side refers to the unfettered powers to the substance and use of a thing. These coincide with the Honoré's incidents mentioned above. The external side is manifest through the remedies of protection of the right, through for example, an action in trespass in English law. However, Rahmatian argues that the main difference between ownership in English law and Civil law is that unlike Civil law, ownership in English law is relative, rather than absolute: it confers title, rather than *dominium*.[357] Rahmatian argues that this is reflected in the way the concepts are protected in both systems. Thus, while Civil law remedies grow out of the real right itself, squeezing out any intruder by the remedy of *reivindicatio*, the English law concept is essentially negative: it emphasis the external aspect, through trespass actions triggered by interference with the property. The negative protection implies that English law, as seen below in the case of the protection of a possessor, protects the best title among competing titles, rather than any absolute right.[358]

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[349] Bridge and others (n 310) paras 2.05-2.11.
[350] Rahmatian, 'German and English Law' (n 8) 211; see also Rahmatian, *Copyright and Creativity* (n 309) where he makes a similar argument.
[351] Honoré (n 18) 108.
[352] ibid.
[353] ibid 108–112.
[354] ibid 113–124.
[355] Rahmatian, 'German and English Law' (n 8) 211.
[356] ibid.
[357] ibid 212.
[358] Rahmatian, *Copyright and Creativity* (n 309) 8–9.

Bridge *et al* also argues that English law recognises a concept of ownership. Similar to Rahmatian, they refer to Honoré's definition above which they describe as the most influential discussion' on the subject in English law , to argue, like Rahmatian, that English law recognises a concept of ownership.[359] They argue that this is further buttressed by judicial authorities, such as *Kuwait Airways Corp v Iraqi Airways Co*[360] and *OBG* v *Allan,*[361] where the courts had used the term 'ownership'. Thus, in their view, the specific mention of that concept by the court connotes some recognition of the concept.

Regarding Rahmatian's analysis, some observations may be made: First, the internal and external sides of his analysis are strikingly similar to the distinction in German law between the positive and negative sides of ownership. The internal side of Rahmatian's analysis, which refers to the unfettered powers to the substance and use of a thing, corresponds with the positive powers under German law seen earlier. Rahmatian's external side, which manifests itself through protection of the assets, similarly accords with German law's negative side which is the power to exclude others. Furthermore, although Rahmatian argues that English law emphasises the external rather than the internal side, this does not suggest, based on Rahmatian's view, that English law does not recognise both sides. It does, but not to the same degree as Civil law.

Based on the similarity between Rahmatian and the position under German law, it seems that Rahmatian's external and internal sides are influenced by the civilian approach. As will be discussed below, this does not fit well with, for example, how beneficial interest is conceptualised under English law, since the positive, or internal side, is not present. This suggests that *contra* Rahmatian, English law does not necessarily define beneficial interest in terms of these two criteria.

Secondly, it seems that when Rahmatian argues that English law has a concept of ownership, he is not referring to a specific concept but writes functionally. This is because there cannot be talk about ownership as a specific concept if property rights in English law are relative, as Rahmatian acknowledges. Nonetheless, in arguing that English law has an 'ownership' concept, Rahmatian may only be arguing, as he acknowledges in other places in

[359] Bridge and others (n 310) para 2.006.
[360] [2002] UKHL 19.
[361] *OBG v Allan* [2007] UKHL 21; see Bridge and others (n 310) para 2.010 where he refers to these cases.

his article, from a functional perspective.[362] Thus, what he does in adopting this functional approach is to identify, comparatively, some idea of 'ownership' in Civil law and Common law, as seen above, based on the concrete real rights vested on a right's holder (i.e. internal and external sides). Thus, because these concrete real rights are, according to Rahmatian, functionally the same in both systems, it can be said, in Rahmatian's view, that English law has an idea of ownership. However, as argued below, Rahmatian's view here contradicts an argument which he makes elsewhere, criticising English law's approach in defining ownership rights in a 'functional sense', in terms of particular effects or the rights vested on a right holder.[363]

More importantly, another reason why Rahmatian's argument can be said not to refer to 'ownership' as a term of art relates to the interpretation of Honoré's definition above. If ownership, as Rahmatian argues (while endorsing Honoré's definition), is the 'greatest possible interest in a thing which a mature system of law recognises', the question is whether this definition can be reconciled with the idea of relativity of title, which Rahmatian himself endorses. The phrase 'greatest possible interest' literally connotes an interest which resembles Civil law ownership in terms of its absoluteness. In English law, there may actually be no such absolute interest, as admitted by Rahmatian and as further argued below. Essentially, this suggests that there is something more to Honoré's definition, which cannot be taken to refer to any specific doctrinal concept in English law.

The point is: rather than focus on Honoré's definition above, it has been suggested that the focus should be on Honoré's incidents of ownership. For example, Bridge argues that it is Honoré's incidents which 'represent an accurate description of the standard incidents of ownership in English law'.[364] Likewise, Smith and Leslie concur that it is the incidents, which together are described as a 'bundle of rights', that represents the highest level of interest in property. They conclude that it is this bundle of right that is termed 'ownership' in English law.[365] What this suggests is that when Rahmatian, from the English law perspective, uses the term 'ownership' in the sense that Honoré uses it, Rahmatian does not refer to a specific concept; rather he uses it, based on the views above, to refer to this 'bundle of rights', which

[362] Rahmatian, 'German and English Law' (n 8) 229, 231, 236, 246. Rahmatian consistently notes that the methodology he applies is a functional approach.
[363] Rahmatian, 'IP and Dematerialised Property' (n 20) 365; Rahmatian, *Copyright and Creativity* (n 309) 6–8 criticising Hohfeld.
[364] Bridge and others (n 310) para 2.007.
[365] Smith and Leslie (n 310) para 2.39.

he reclassifies as the internal and external sides of ownership. [366] The bundle of rights is what he presupposes as the real right of ownership in English law.

However, Penner,[367] whose analysis Rahmatian accepts. [368] has robustly rejected this approach. To understand Penner's argument, it is helpful to provide some context. Property rights in English law are often described in terms of a 'bundle of rights.[369] This description is a combination of Hohfeld's analysis of rights, which is discussed in section 6.4 and Honoré's incidents above. A real right, according to Hohfeld, is not to be described as a right in a thing but as a series of rights vested in a right's holder against everyone each of whom has a correlative duty not to interfere with the right of the right-holder in the thing. The right is treated as a bundle of rights which the right-holder has against many others. This is divided into individual sticks of claims, liberties, powers and immunities, all making up a bundle. Honoré elaborates on these individual sticks by describing them, as seen above, as incidents of ownership, making up the rights, powers, and liberties normally vested in an owner by liberal legal systems.

Penner, followed by Rahmatian, challenges this view. [370]First, Penner notes that Hohfeld's analysis, and indirectly Honoré's, does not represent correctly what happens in a transfer. According to him, Hohfeld's view implies that in a transfer of property everyone exchanges the duty owed to the owner for another duty owed to the acquirer. Penner argues that this view is 'bad', and the better view is that only the owner's and acquirer's rights and duties have changed. Secondly, he notes that rather than being described as a 'structural composite' made of independent sticks, as falsely misrepresented by the bundle of rights analysis, a property right is rather 'a single right protecting a single, identifiable interest'.[371]

Like Penner, Rahmatian also takes an integrated approach. He notes that the bundle of rights problem can be resolved using the Spinozian distinction between 'substance' and 'attribute'. The substance of a real right refers to the real right itself , existing as an abstract, unified concept. The real right is then concretised into individual real rights, which are aspects of the whole, rather than being independent sticks, as suggested by Hohfeld and Honoré. As earlier noted, Rahmatian

[366] Rahmatian, 'German and English Law' (n 8) 210.
[367] James Penner, 'The Bundle of Rights Picture of Property' (1996) 43 UCLA L Rev 711; James Penner, *The Idea of Property in Law* (Oxford University Press 2000) 23.
[368] Rahmatian, 'IP and Dematerialised Property' (n 20) 365.
[369] Stephen Munzer, *A Theory of Property* (Cambridge University Press 1990) 22–36; Jeremy Waldron, *The Right to Private Property* (Oxford University Press 1990) 22-36,59-60; see also references in Penner, 'Bundle of Right' (n 367) 711 footnote 1; for doctrinal writers, see: Smith and Leslie (n 310) para 2.39; Beale and others (n 279) para 2.006; Benjamin (n 258) para 13.55.
[370] Penner, *The Idea of Property* (n 367) 23; Rahmatian, 'IP and Dematerialised Property' (n 20) 365.
[371] Penner, 'Bundle of Right' (n 367) 739.

divides these concrete real rights into an external and internal side.[372] Essentially, what he and Penner suggest is that we cannot define the real right based on the individual rights, as Hohfeld and Honoré claim. Rather, the right of ownership should be seen as a single right.

The argument here is that if Honoré had used the term 'ownership' to refer to a recognisable, single concept, there will be no need for Penner and Rahmatian to reply to his position. Thus, he uses that term not as a single concept or a term of art to denote any particular system, since he himself refers abstractly to any 'mature system'. He rather uses it to refer, as seen above, to the individual rights vested in a right holder. It is therefore wrong to suggest, as Rahmatian seems to do, that Honoré' definition implies the existence of a concept of ownership in English law, or that, as Rahmatian and Penner suggest, that the bundle of rights picture implies some idea of ownership.

The discussion above also answers the issues raised by Bridge *et al* highlighted earlier, that English law recognises a concept of ownership. As noted, they refer to Honoré's definition above as well as the decision in *Kuwait Airways Corp v Iraqi Airways Co* [373] where the court had referred to the term 'ownership' to hold that the remedy of conversion protects 'ownership'. According to Bridge *et al*, the specific mention of the concept of ownership demonstrates that such a concept exists in English law.

However, as argued above, reference to that term does not necessarily indicate the recognition of ownership. As Nolan rightly suggests,[374] there is no general concept of ownership under English law. Hence, the usage of the term in that case can only be read in line with its own peculiar facts. The term is not used with any specific meaning and consequences, but may refer to, as the court noted in *Yearworth v North Bristol NHS Trust*, 'no more than a convenient global description of a different collection of rights held by persons over physical and other things'.[375] Honoré's abstract definition above which does not refer to any particular system (i.e. any 'mature system') [376] is likewise used in this sense: not really to depict a specific doctrinal concept, but as a 'collection of rights' vested in a person.

In this regard, Swadling seems to summarise the position aptly, that 'English law has no notion of ownership'.[377] This statement applies to interests both under the English common

[372] Rahmatian, *Copyright and Creativity* (n 309) 6–8.
[373] [2002] UKHL 19.
[374] Richard Nolan, 'Equitable Property' (2006) 122 LQR 232, 258.
[375] [2009] EWHC Civ 37 [28].
[376] Honoré (n 18) 108.
[377] Swadling, 'Ignorance and Unjust Enrichment' (n 346) 640.

law and equity,[378] and in respect of personal property, either choses in possession or choses in action, although Fox, as seen below, argues that a unitary right of ownership exists in respect of choses in action because of the inapplicability of the concept of possession to such interests.[379]

5.4.1.1 Full ownership in English law in terms of the remedies?

Before we consider the concept of title in English law within the context of the common law and equity, it is important to address one likely objection which may arise in relation to the argument on English law in this chapter. It may be argued that the strength of the remedies accorded to a title holder in common law and equity are functionally equivalent to the Civil law remedy of *vindicatio*.[380] Therefore, because the strengths of the remedies are functionally equivalent, this implies that we can identify a system-neutral concept of full ownership. [381]

This line of argument can be distilled from Rahmatian's argument discussed earlier where he argues that in every system, the real right of ownership can be split into an internal side and an external side. Importantly, regarding the external side, he argues that it manifests in the remedies protecting the right of ownership, [382] or put differently 'in the right to exclude everybody except the rightsholder from the object of the real right'.[383]

In the above light, Rahmatian, in his analysis on the 'protection of ownership' across English and Civil law, discusses the remedies available to a title holder in English law, who may bring an action for trespass or conversion (founded on the right of possession or right to immediate possession), and the Civil law remedy of *vindicatio*. On the one hand, Rahmatian acknowledges that these remedies are conceptually different: while the English concept of ownership is essentially negative, in that it emphasises conceptually the external aspect and

[378] From the perspective of equity, see: Nolan (n 374) 258.
[379] Fox (n 325) 361–363.
[380] In common law, title is protected through the law of torts which require a party to be in possession or have a right to immediate possession, although this is not the case for claims regarding reversionary injury. The relevant torts are trespass, conversion and reversionary injury: the tort of trespass protects a possessor against interference with chattels in his possession.; secondly, the tort of conversion protects the possessor against unlawful appropriation of his chattel; and lastly, reversionary injury protects a party who has title to chattel (but who is not in possession) against damage to his reversion. This last remedy arises where, for example, a title holder leases his chattel to a third party. The remedy allows the title holder, as a reversioner, to recover any loss suffered on account of the lessors usage of the chattel . On the remedies of trespass and conversion, see the very useful discussions in Rahmatian's work: Rahmatian, 'German and English Law' (n 8) 214–216; see also Smith and Leslie (n 310) chs 29–30.
[381] Rahmatian, 'German and English Law' (n 8) 214–216. .
[382] ibid 211.
[383] Rahmatian, 'IP and Dematerialised Property' (n 20) 368.

looks at the extent to which tort (trespass) actions , as a result of an interference, can or cannot be brought, Civil law ownership is principally positive, in that it focuses conceptually on the internal aspect: 'it has the realm of real right itself in mind'.[384] Regardless of this conceptual distinction, Rahmatian suggests, as noted, that the remedies are functionally equivalent since they are a manifestation of the external side of the real right in both systems, to exclude everybody aside the right holder from the object of the real right. For example, he argues that the remedy of conversion can 'act as a kind of substitute for a *rei vindicatio*'.[385] In essence, this implies that the remedy serves a functionally equivalent purpose, with the effect that it can be concluded, broadly, that there is a right of ownership in both English and Civil law since the rights are protected against third parties, although using different mechanisms.

The line of argument above attempts to extrapolate a system-neutral meaning using the remedies available to a title holder in English law and owner under the Civil law. However, it may be argued that instead of focusing on whether the remedies have the same effect so as to qualify as a right of ownership, the proper focus should be on the nature of the rights on which those remedies are based. In sections 5.4.5.1 and 6.5, some arguments have been made in support of the position that what is important is the nature of the right, rather than the equivalent effects of the remedies. However, we will briefly summarise the argument here: first, as Rahmatian rightly notes, the remedies are only a manifestation of the external side of the real right. Essentially, this external side are proprietary because they are directed at third parties who are excluded from interfering with the object of the real right. In other words, what brings the remedies together is that they all protect the right holder from non-interference by third parties. This point is confirmed by the discussion in section 6.5, where, as discussed, Rahmatian argues that obligations or incorporeals are objects of ownership because they are protected by the tort of knowingly inducing a breach. Thus, because the remedy, and other remedies such as the tort of trespass and conversion, are directed at third parties, it implies that the protection is proprietary. However, as argued in sections 5.4.5.1 and 6.5, it does not follow that a right is a real right because it is directed at third parties. Third parties may be liable under a contract on grounds of collusion, but that does not make the right a real right.[386] Furthermore, as elaborated in section 6.5, there are several factors that give rise to the temptation to define property in terms of its exclusionary effects against third parties. One of such temptations is the Hohfeldian definition discussed in detail in section 6.5, which, as will be noted in that

[384] Rahmatian, *Copyright and Creativity* (n 309) 9.
[385] Rahmatian, 'German and English Law' (n 8) 215.
[386] Gretton, 'Trusts without Equity' (n 306) 602.

section, defines a right *in rem* in terms of the party against whom it is exigible. Rahmatian rightly criticises Hohfeld's definition of real right, as discussed in that section, as amounting to 'merely particular manifestations of personal rights'.[387] This suggests that what counts is not the effects but substance of the right.

Moreover, the criticism above may be further buttressed if it is considered that some of the remedies, such as the tort of trespass and conversion, which Rahmatian describes as proprietary, are sometimes characterised as 'personal proprietary claims' in English law.[388] In this regard, Smith and Leslie note that the protection of interests in chattels are based on an interplay of principles of property, tort and contract.[389]

Based on the foregoing, three observations can be made: first, that the remedies, broadly speaking, provide a limited indicator of any system-neutral definition of 'full ownership'. Although the remedies may tell us that the rights are exigible against third parties, the criteria of exigibility is not, on its own, a clear indicator of ownership, since, as mentioned, personal rights are exigible as well. Secondly, the analysis above suggests that the remedies, in English law, cannot expand or change the nature of the underlying right; it can only give effect to the right to a greater or lesser extent. Thus, if there is material asymmetry in the formulation of the underlying right, that difference can never be cured by the remedies, even adopting a functionalist perspective. Therefore, the fact that the remedies may be equally effective cannot resolve any material asymmetry in the formulation of the underlying right. Thirdly, because the remedies are not clear indicators of full ownership, there is the need to consider the nature of the right on which the remedies are based to understand their nature. The discussion on English law, especially on equity, therefore, considers the issue from that perspective.

5.4.2 Absolute ownership as the best right to possession

Possessory rights lie at the heart of the controversy on relativity of title. Because of this, the discussion of relativity in the common law centres on assets which are capable of being possessed. These assets include things in possession, such as goods (which do not fall within the focus of this work) or things in action which are in a documentary form (documentary intangibles). However, for pure intangibles, which may not be possessed, there is an argument that title in them is not relative.[390] Fox argues that 'it is generally impossible to have a relative

[387] Rahmatian, 'IP and Dematerialised Property' (n 20) 365.
[388] Smith and Leslie (n 310) paras 30.06-30.08.
[389] ibid.
[390] Fox (n 325) 361–363.

legal title to a purely intangible asset' such as a registered share which deals with legal ownership. [391] This is because only one person is entitled to them at any time: the registered holder of the securities or the creditor regarding a debt. Fox argues that the right is necessarily unitary because it is not represented by any corporeal thing which can be possessed. Because such a right cannot be possessed, it is difficult to generate an equivalent legal title in the same asset, though in the case of an equitable interest, it is perfectly possible to have numerous numbers of equitable interests in the same intangible asset.

Admittedly, it is possible that only one right may exist in intangible property at any given point. However, this does not suggest, as Fox does, that the common law, recognises a concept of unitary ownership in choses in action. It is questionable if there can be such a concept when its existence is dependent on the type of asset and the type of (right) a party has in such an asset. Fox's idea can be said to reflect the deductive approach of English law in determining legal issues individually based on particular facts, rather than on having *a priori* legal concepts. Essentially, Fox's idea is itself relative and does not point to the existence of a concept.[392]

As noted above, the discussion on relativity deals primarily with the importance placed on possession as a root of title. If assets cannot be possessed, then the interest in them can either be legal or equitable on the one hand or multiple equitable interests (existing at the same time) on the asset. There cannot be two legal titles in them, as in the case of relative titles, because of the absence of a possessory title in such asset.

Relativity of title under English law will involve a question of who has the better legal title to an asset based on possession. English law treats a party in possession as an owner and therefore confers ownership rights on him.[393] This principle is described by Pollock as a prominent part of medieval English law applying to both land and chattels.[394] However, Pollock acknowledges that this may lead to unjust outcomes. He notes that it may lead to the law ascribing property rights to a wrongdoer who is able to acquire possession unlawfully.[395] However, he points out that protecting the wrongdoer may be necessary to protect third parties or the order of the society. According to him, the possessor has all the 'powers of an owner',[396]

[391] ibid 330.
[392] It is based on the type of asset.
[393] Frederick Pollock, *A First Book of Jurisprudence for Students of the Common Law* (3rd edn, 1911) 182.
[394] Frederick Pollock and Robert Samuel Wright, *An Essay on Possession in the Common Law* (1888) 93.
[395] ibid 3.
[396] Pollock (n 393) 181.

meaning that he can use and dispose of the property as an owner as well as to bring an action against everyone in violation of his right. The only restriction on his title is that his possessory right is defeasible as against a party who can show a better title to the property. In essence, title lies in favour of a party who can show a better right to possession.

This competitive approach which is focused on whose title is best means that English law historically handled 'property questions relatively'.[397] The question is which of the parties has the best right to possession, rather than the absolute right to the asset. Consequently, instead of the claimant seeking a return of the property, the relief often available is one of compensatory damages for conversion. In this regard, Swadling points out that it is logical that English law can have no concept of ownership if it is committed to the notion of a relative title based on the best right to possess.[398] Bridge agrees with this opinion.[399] He notes that the concept of property rights in English law can only be described in terms of the party who has priority in terms of entitlement to possession. He further identifies the owner of a chattel as the person with the best possessory interest in it.

However, contrary views have been expressed which moves English law towards a unitary system of absolute ownership. Goode for example contends that absolute ownership may exist where the interest is absolute and the title indefeasible.[400] An indefeasible title will be the best legal title over the asset. Sheehan similarly argues that absolute title does in fact exist in English law: that a person has a better title than others means that his title is that of an absolute owner.[401]

Two observations may be made in respect of the above. First, it will seem that absolute ownership, on Goode's view, is dependent on who has indefeasible title which cannot be defeated. Implicit in this idea is the fact that another party may have a competitive title based on an equally valid right. This still suggests that title is relative if its indefeasibility is based on who proves a better title. This does not necessarily imply the existence of a concept of ownership, but merely affirms the point that title is relative and based on particular facts regarding who has the better, indefeasible right to possess.

[397] Peter Birks, 'The Roman Law Concept of Dominium and the Idea of Absolute Ownership' [1985] Acta Juridica 1, 27.
[398] Swadling, 'Ignorance and Unjust Enrichment' (n 346) 641.
[399] Bridge (n 313) 32.
[400] McKendrick (n 305) 36.
[401] Duncan Sheehan, *The Principles of Personal Property Law* (2nd edn, Hart Publishing 2017) 15.

Secondly, regardless of the absence of a concept of unitary ownership, a possessor in the common law and an owner of a chose in action can functionally exercise all the rights normally vested in an owner. They have the right to use, reap the fruits as well as dispose of the assets and also vindicate the right against everyone apart from a party with the best title. In this light, the results associated with Civil law ownership is also present in common law title. However, even if the contents of these rights are equivalent, Penner's analysis above suggests that we cannot define a real right, or the right of ownership, in terms of those particular effects alone. Those effects can, normatively, only be seen within a system of rules which work together for a specific purpose. They cannot individually tell us anything about the principles behind them. Besides, even if we are to accept that common law rights are equivalent to Civil law ownership, and thus give rise to full ownership, how do we accommodate beneficial interest? Does it mean that, within the context of the TTFCA Directive, while legal title is full ownership, beneficial ownership becomes a lesser right? This may be a legitimate point when seen within the context of the fragmented right in a trust. Thus, because possession is indivisible, the necessary implication of that is that a beneficiary cannot have the same powers as the trustee in the assets.

5.4.3 Beneficial right: historical background

The institution of beneficial ownership exists only in equity.[402] Its origin is linked to the Crusaders.[403] It is said that before the Crusaders went to war, they often transferred their property to a trusted friend for the benefit of their family members. The transfer was normally made to evade specific common law tax and succession rules which became operative if the Crusader did not return. The common law did not recognise this sort of arrangement. If the Crusader was killed, there was no remedy available to his family members on basis of the property which was transferred to the trusted friend. Also, if the Crusader was fortunate enough to remain alive, the common law did not also recognise his rights in the property, as it was considered that he had transferred his legal title to his friend. The friend was therefore treated as the owner. However, it came to be that upon the death of the Crusader, family members who were desirous of getting some benefits from the property petitioned the Chancellor who was responsible for the Court of Chancery. By the 13th century, it is said that the Chancellor began to enforce the obligations imposed on the trusted friend.[404] The Chancellor ordered that the trusted friend was the legal owner of the property under the common law, but insisted that he

[402] Worthington (n 321) 8.
[403] ibid 63.
[404] ibid 63–64.

was bound to manage the property for the benefit of the beneficiaries. Maitland confirms this point. He notes that within this period the rule under equity was not that 'the *cestui que trust* [beneficiary] was the owner of the land, it said that the trustee was the owner of the land but added that he was bound to hold the land for the benefit of the *cestui que trust* [beneficiary]'.[405]

The Chancellor gradually developed certain rights in favour of beneficiaries, on the basis that the trusted friend was bound, in conscience, to manage the property for their benefits. Using the old expression in equity, this reflected the fact that equity acted *in personam* to bind the trustee's conscience to fulfil the promises or obligations made to his friend.[406] Out of this arrangement, equity therefore developed the institution of trust. What was formerly a personal arrangement for the purpose of evading some legal rules became systematised, so that it formed a body of rules regulating similar future arrangements. The trust therefore developed into a defined institution between a settlor and the trustee under which the trustee holds property for the beneficiary's benefit.[407]

From the foregoing, it is clear that equity started off as a personal obligation between the trustee and the beneficiary. It never required that third parties needed to recognise the beneficiary's interest. Its unwillingness to extend its jurisdiction was to avoid any 'judicial rivalry' with the common law courts, as converting a purely personal right to a proprietary right would have undermined the common law courts. [408]

Equity extended its jurisdiction with time. It allowed the beneficiary's rights to be enforced against third parties.[409] The remedy available to the beneficiary was expanded to apply against volunteers who paid no consideration for the trustee's title,[410] and additionally against any third parties who knew or ought to have known of the beneficiary's rights in the property.[411] In contrast, parties who purchased without notice were not bound by the interest of the beneficiary. They took the trust property free from the trust. It is said that the reason why such innocent purchasers were excused by equity was because their conscience was not affected. Additionally, if innocent purchasers of the legal estate were bound by the beneficiary's interest,

[405] Frederic Maitland, *Equity, Also the Forms of Action at Common Law* (AH Chaytor and Whittaker eds, Cambridge University Press 1910) 17.
[406] Sheehan (n 401) 21.
[407] Worthington (n 321) 66.
[408] Ming Wai Lau, 'The Nature of the Beneficial Interest: Historical and Economic Perspectives' (2013) 56 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2213055> accessed 1 March 2017.
[409] McKendrick (n 305) 42.
[410] *Re Brooks Settlement Trust* (1939) 1 Ch 993, 998.
[411] Worthington (n 321) 65,95-96.

that would have made the beneficiary's interest equal or better than the legal title under common law. This would have created 'competing property systems'.[412]

By the end of the 19th century, the idea of equitable ownership had become solidified. The beneficiary could exercise all rights of ownership over the asset, including the right to transfer or convey his interest *inter vivos* or bequeath his interest to his heirs.[413]

The trust therefore gives rise to 'divided ownership': the trustee is the legal owner and the beneficiary is the beneficial owner.[414] This arrangement is not one of co-ownership but of different property rights. However, as will be discussed below, it is controversial if the beneficiary's interest gives rise to a right *in rem*. Even if it does, it also seems that such an interest cannot be classified as an ownership interest, as authors who admit that it gives rise to a right *in rem* accept that the term 'ownership' may not accurately reflect such an interest, because of the 'many or varied interests under a trust'.[415]

It is important to note that beneficial interest under a trust arrangement is the 'paradigm case' under equity in relation to the nature of equitable interest.[416] It is commonly used to explain the nature of an 'absolute' interest which may exist in equity.[417] However, equitable interest may arise in other non-trust arrangements: for example, in a defective transfer of title under common law,[418] or where an after-acquired asset is transferred under the law, or additionally where there is an express agreement to transfer equitable interest.[419] In these situations , the rights created may have the same effect in equity similar to the rights of the beneficiary under a trust. But, as stated, it is within institution of a trust that the beneficiary's right was first recognised.[420]

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[412] Lau (n 408) 19.
[413] Worthington (n 321) 64; Maitland (n 405) 113. However, a beneficiary does not have the right to possession of the trust asset or conversion which is based on possessory rights. See the discussion in section 5.4.4. and the case of *MCC Proceeds Inc v Lehman Brothers International (Europe)* (1998) 4 AER 675, 675; see also Andrew Tettenborn, 'Trust Property and Conversion: An Equitable Confusion' (1996) 55 Cambridge LJ 36, 38.
[414] McKendrick (n 305) 42.
[415] Nolan (n 374) 258.
[416] James Penner, 'The (True) Nature of a Beneficiary Equitable Proprietary Interest under a Trust' (2014) 27 Can J.L & Jurisprudence 473, 474.
[417] McKendrick (n 305) 34,44. Goode notes that equitable interests may be absolute or limited. Goode defines an absolute interest holder as the person who has the residue of rights in an asset after specific rights have been granted to others. It may be contrasted with a limited interest, i.e. security right.
[418] Which may take effect in equity.
[419] McKendrick (n 305) 43; Sheehan (n 401) 30.
[420] Penner, 'Beneficial Property' (n 416) 473.

Before examining the arguments on whether beneficial interest gives rise to a right *in rem*, the section below will look at the rights of the beneficiary and the trustee. This discussion helps to clarify the controversy on why equity could be said to act *in personam* or *in rem.*

5.4.4 Division of rights between trustee and beneficiary

As seen above, a trust may be defined as an institution between a settlor and the trustee. The trustee has legal title, while the beneficiary retains the beneficial interest. By legal title is meant that the trustee can exercise all the rights under the common law vested on a legal title holder. Significantly, this will include the right to possession or to sue for conversion which is based on possession. Under English law, as seen in the discussion on relativity of title, possession is a legal right protected under the common law. A beneficiary is therefore not vested with this right, though he may have the right to immediate possession if he was in actual possession. Even where he is in actual possession, only the trustee can bring an action for conversion.[421]

The beneficiary is entitled to the benefit of the trust asset. Where the trustee uses the property for some personal gain, any benefits can be stripped from him.[422] His duty is to the beneficiary when dealing with the trust asset. However, this benefit does not accrue to the beneficiary because of his direct relationship to the asset, but because of the personal obligation on the trustee to use the asset for his benefit.[423] This lack of any direct relationship with the asset means that any rights in the property derive through the trustee's right.[424] His right is parasitic and derives from the rights of the trustee. For example, where a third-party causes damage to the property, the beneficiary cannot directly claim against the third party.[425] That must be done by the trustee. Also, as seen above, where the property is stolen, only the trustee can bring a suit for conversion. However, it is important to note that the beneficiary can always compel that the trust property be transferred to him under certain conditions.[426]

This division of rights between the trustee and beneficiary indicates that a trust gives rise to two relationships: first, between the trustee and the trust asset in relation to third

[421] *MCC Proceeds Inc. v Lehman Brothers International (Europe)* (n 413) 675; Tettenborn (n 413) 38.
[422] See generally the duties of the trustee: Jamie Glister and James Lee (eds), *Hanbury & Martin:Modern Equity* (21st edn, Sweet & Maxwell Ltd 2018) pt III. See also specific statutes of a Trustee, under the Trustee Investment Act 1961 and the Trustee Act 2000.
[423] Sheehan (n 401) 21–22.
[424] Lionel Smith, 'Trust and Patrimony' (2008) 28 Est Tr & Pensions J 332.
[425] ibid 343.
[426] *Saunders v Vautier* (1841) 41 ER 482.

parties;[427] secondly, between the beneficiary and the trustee imposing an obligation on the trustee to manage the property to the beneficiary's benefits. The question, then, is : how is the beneficiary's right to be conceptualised, since he has no direct right to the property?

5.4.5 Is beneficial interest 'ownership'?

Before considering the above question, it is important to note that although the issue in this section is about ownership, the debate below deals with whether beneficial interest is a right *in rem* or a right *in personam*, or *right in a right*. Even if it is agreed that beneficial interest is a real right, another question is whether it is 'ownership'. As Nolan admits below, it is arguable whether beneficial interest qualifies as 'ownership'. However, he contends, as discussed below, that it still gives rise to a real right.

The controversy surrounding the nature of the beneficial interest has two sources.[428] The first, as seen above, is that on the creation of a trust, the powers to deal with the asset are divided. Secondly, the institution of equity historically only acted in *personam* on the trustee to manage the asset for the beneficiary's benefit.

It may be said that between the beneficiary and trustee, certain obligational rights exist on the trust property. For example, where the trust instrument imposes an obligation on the trustee to invest certain amounts on behalf of the beneficiary, failure to act only gives rise to a personal right in favour of the beneficiary. The beneficiary, for instance, cannot sue a third party to carry out such an activity. However, where the trustee has misappropriated the asset or transferred it *inter vivos* to a family member or maybe goes insolvent, the question is whether the beneficiary's interest in the asset can survive any of these events. As seen above, there appears not to be a direct relationship between the beneficiary and the asset. Therefore, on what basis can the beneficiary claim any proprietary right in the asset against third parties?

As suggested, the above raises a controversial point about whether beneficial interest is a right in *rem* or a right in *personam*, not necessarily an ownership right. For this reason, the opinions canvassed in texts normally relate to whether a beneficial interest binds third parties and not whether it is ownership. An equitable interest may indeed not be 'absolute ownership'

[427] Tatiana Cutts, 'The Nature of "Equitable Property": A Functional Analysis' (2010) 4 Journal of Equity 44, 48; Sheehan (n 401) 20–21.
[428] Penner, 'Beneficial Property' (n 416) 477.

since it may be defeasible and does not give the equitable 'owner' certain rights, importantly, the right to possession.[429]

The debate on whether a beneficial ownership gives rise to a right *in rem* or *personam* goes back to the early 20th century [430] and still arises today.[431] On one side of the debate, it is contended that beneficial ownership is a right *in rem* because it is binding on third parties with notice of the beneficiary's interest.[432] The beneficiary can also exercise rights of ownership such as bequeath his interest to a third party or sell, mortgage or alienate the asset generally.[433] His interest is also protected in the trustee's insolvency, as it cannot be included in the trustee's assets. The beneficiary can trace such assets by claiming his continued interest in the original assets into the hands of a third party, or by asserting his interest in the traceable proceeds.[434] These suggest that the content of the right is similar to the right of ownership in Civil law, and even for common law title, though one difference is that a beneficiary has no right to immediate possession.

Nolan offers a recent conceptual analysis of the nature of a beneficiary's interest. According to him, the beneficiary's 'core' proprietary right under a trust consist in the primary, negative right to exclude non-beneficiaries from the asset.[435] A violation of this primary right[436] generates a vindicatory right [437] in the form of a 'claim to recover misapplied trust assets, or their traceable proceeds, or an interest in such proceeds' from third parties.[438] According to

[429] Goode's argument affirms the point that it cannot give rise to absolute ownership. He defines 'absolute ownership' under English law as an interest which is absolute, and which is not defeasible. Equitable titles are defeasible, therefore, they cannot give rise to 'absolute ownership' based on Goode's explanation. McKendrick (n 305) 36.
[430] Those in favour of the proprietary nature: A Whitlock, 'Classification of the Law of Trusts' (1913) 1 Cal L Review 215; William Walsh, 'The Nature of Equitable Rights and Equitable Title' (1929) 18 Geo LJ 36, 36; Austin Wakeman Scott, 'The Nature of the Rights of the Cestui Que Trust' (1927) 17 Columbia Law Rev 269. Maitland supports the view that it is a right in personam: see Maitland (n 405),lecture IX on the nature of equitable interests.
[431] Recent authors in support of the obligational nature of the beneficiary's interest: Ben McFarlane, *The Structure of Property Law* (Hart Publishing 2008) 551; Ben McFarlane and Robert Stevens, 'The Nature of Equitable Property' (2010) 4 Journal of Equity 1; Smith (n 424). Those in favour of the proprietary nature include: Nolan (n 374); Glister and Lee (n 422).
[432] Worthington (n 321) 65.
[433] Walsh (n 430) 39–40; *Sinclair v Brougham* [1914] AC 398, 444; *Tinsley v Milligan* (1994) 1 AC 340, 371.
[434] In *Foskett v McKeown* (2001) 1 AC 102 (HL), the House of Lords held that ownership of property traceable followed as a matter of property law. The owner was entitled to any benefits obtained from the use of that property.
[435] Nolan (n 374) 234.
[436] ibid. The primary right, in Nolan's analysis, is the right to exclude non-beneficiaries.
[437] ibid 236.
[438] ibid 251.

Nolan, the beneficiary may also have some 'positive rights' to the trust assets, which confer on him rights to benefit from those assets. These positive rights may exist in line with the primary, negative rights, but they are not themselves to be regarded as determining the core proprietary features of the right. To Nolan this is because, unlike the primary, negative rights which are consistent, the positive rights are 'variable'.[439] Nolan notes that a 'cursory examination of trust documentation' confirms the variable nature of the positive rights.[440] However, he suggests that the positive rights may be proprietary for particular purposes because they may confer on the beneficiary the 'privileged access to benefit' from the trust asset.[441]

Nolan's analysis misses some key issues. First, the right to exclude is not distinctive of equitable interest. The right is also central to normal legal ownership. The traditional school of American property theorists, and Penner,[442] describe standard legal title as the right to exclude, which is a negative right. In American property law literature, this right is said to be the 'most essential'[443] and 'central defining'[444] characteristic of ownership. If this is the case, it therefore means that the negative right to exclude is not a distinctive feature of beneficial ownership, as Nolan suggests. Normal legal ownership is likewise characterised in the same way. Does this mean that there are no distinctions between beneficial interest and legal ownership, as conceived by some property theorists?[445] However, this cannot be the case, since it defeats the presupposition in Nolan's theory which seems to set out a justificatory concept for beneficial interest as a distinct category. Moreover, although theorists like Penner may define ownership as a negative right of exclusion, he accepts, unlike Nolan, that both the positive and negative rights are sides of the same coin.[446]

Relatedly, Nolan seems to have a different definition of a right *in rem*.[447] Based on his analysis above, the beneficiary's core proprietary right is the primary, negative rights to

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[439] ibid 238.
[440] ibid, footnote 26.
[441] ibid 237–238.
[442] Penner, *The Idea of Property* (n 367) 68–104.
[443] Thomas Merrill, 'Property and the Right to Exclude' (1998) 77 Neb LR 730; Thomas Merrill and Henry Smith, 'What Happened to Property in Law and Economics'' (2001) 111 Yale LJ 257. See also the US Supreme Court decision in *Kaiser Aetna v United States* (1979) 444 US 164.
[444] Larissa Katz, 'Exclusion and Exclusivity' (2008) 58 U Toronto LJ 275-375.
[445] With effect that both have the same effect.
[446] Penner, *The Idea of Property* (n 367) 70–71.
[447] Nolan (n 374) 236. Nolan proposed a definition of a right *in rem* 'for the purpose of [his] article'. He defines a right *in rem* as a right which has the capacity to give rise to a 'primary right to exclude anyone of a very large and indefinite class of people from access to some enjoyment of the asset…and the secondary claims to vindicate that primary right'. He further points out that such primary right may give rise to 'possibility of access to benefit accruing from the asset' (i.e., positive rights), but these positive rights are not the core proprietary elements of a right *in rem*.

exclude third parties. This right is distinct from the beneficiary's positive rights to derive any benefits from the asset. Essentially, both rights are separate. However, this view seems to miss the fact that the 'positive' rights and the 'negative' rights, as stated above, are 'opposite sides of the same coin'.[448] Both rights are 'intertwined' and make up what constitutes a right *in rem.*[449] '[N]o one has any interest in merely excluding others from things, for any reason or no reason at all'.[450] What underpins proprietary interest is the interest in dealing with the asset. Hence, a proprietary right cannot be defined based on the negative right to exclude others. Instead it is defined as giving rise to both positive and negative rights which are intertwined, as Rahmatian suggests earlier.

Civilian systems adopt a definition which embraces both the positive and negative rights. It was noted earlier that German law treats ownership in the same way. The positive side refers to the power of the owner to use, enjoy and dispose of property. The negative side refers to the power to exclude everyone from such use and enjoyment. Conceptually, the negative side, like Nolan's account, has the correlative obligation binding on others 'not to do something'.[451] However, taken together these powers define the right of ownership as the primary real right. As argued earlier, the absence of the positive or internal side of the right in beneficial interest renders Rahmatian's criteria used in identifying ownership in English law questionable, as they seem to be Civil law influenced.

Nolan's analysis may therefore be too narrow. As mentioned above, a right *in rem* is defined by both the negative and positive rights vested in an owner. Nolan's definition, on the contrary, only focuses on the negative side. This may not give the beneficiary enough access to qualify it as a property right in the thing. It is therefore questionable if beneficial interest, as described by Nolan, is a right *in rem*.

However, one may argue that because the trustee holds the property for the benefit of the beneficiary, this means that the beneficiary functionally has the positive powers. Thus, this effect functionally draws it closer to the positive powers under Civil law ownership. Functionally, this may be close to accurate, but it is questionable whether such indirect positive powers qualify as ownership, since its exercise is based on a personal obligation from the

[448] Penner, *The Idea of Property* (n 367) 70–71.
[449] ibid 68.
[450] ibid 70.
[451] In Hohfeldian analysis, this will be a 'no-right'. It is difficult to see how a positive obligation can be universal. Reid (n 307) 227.

beneficiary to a trustee. This essentially is a personal right, not a real right, and may not fall within the Directive.

In contrast to Nolan's conceptual analysis, beneficial ownership has also been argued not to give rise to a right *in rem* but what is called a right in the right of the trustee in the asset,[452] or rather 'a right against the trustee in respect of the trustee's exercise of the right' in the trust asset.[453] Similarly, it is claimed that "an equitable property right is neither a right against a person, nor a right against a thing, rather it is a right against a right.[454] '[T]he rights of the beneficiaries are neither purely personal rights against the trustee, nor are they real rights in the trust property' but rather they are rights over the rights which the trustee holds in the trust property. [455] They may have a proprietary character, in that they 'persist' against third parties, but such rights only derive from the trustee's title in the asset, not from any right of the beneficiary in the asset. [456] Any right which the beneficiary has in the trust property only derives from or is 'engrafted' on the trustee's right.[457]

The question in this chapter is whether beneficial interest is ownership. The discussion above reveals that English law refers to the rights of the beneficiary as a right *in rem*. One of the reasons for this, as seen above, is that the beneficiary exercises some rights of ownership over the asset, such as the right to bequeath or transfer the asset to a third party or convey same. However, the question is whether these are enough to classify such an interest as an ownership interest?

Nolan provides an argument in support of the proprietary nature of beneficial interest. However, he admits that in construing the nature of such an interest:

> The creation of many and varied interests under a trust may well mean that no particular person (or persons concurrently) can claim to hold the full panoply of rights known as 'ownership' if that term is understood to mean a right of exclusive enjoyment [….] A trust may simply fragment such rights amongst a class of people.[458]

[452] McFarlane (n 431) 551; McFarlane and Stevens (n 431) 37 where they apply their theory to the beneficiary's interest in intermediated securities.
[453] William Swadling, 'Property: General Principles' in Andrew Burrows (ed), *English Private Law* (3rd edn, OUP 2013) para 4.151.
[454] McFarlane and Stevens (n 339) 37.
[455] Smith (n 424) 332.
[456] ibid.
[457] *Re Transphere Pty Ltd* (1986) 5 NSWLR 309, 311.
[458] Nolan (n 374) 258.

He adds that even though such an interest may not be ownership, the beneficiary's interest still has a proprietary effect.

Three issues arise from the preceding discussion. The first issue is whether beneficial ownership may be conceptualised as a type of (limited) real right? This issue is premised, as seen below, on the fact that Nolan's evaluation does not account for how a negative right sets up a positive right where the trust property is misapplied. The fact that a positive right, which is different from a negative right, is created when a trust property is misapplied may imply that the beneficiary's right is not a real right. The nature of a real right is that it remains the same irrespective of the party in possession. It follows the asset. The second issue is whether beneficial ownership may qualify either as ownership under a TTFCA, or as a real right under an SFCA? This issue is premised on the fact that, as Nolan admits, beneficial interest may not be ownership because the rights to the trust property are fragmented. But it may be a real right. In this regard, the Directive demarcates between TTFCA (under which the 'primary real right' of ownership is transferred) and SFCA (which creates a subordinate real right). The primary question then is whether beneficial ownership, which Nolan treats as a 'right *in rem'*, is either a TTFCA or an SFCA.

The third issue is whether anyone in a trust can be said to have 'full ownership' within the context of a TTFCA under the Directive? This issue arises because, as Nolan notes, a trust 'fragments' or divides the interest between the beneficiary and trustee. These three issues will be analysed separately below.

5.4.5.1 Beneficial interest as a type of real right

The first issue is whether beneficial ownership is a type of real right, i.e. limited real right rather than ownership. As seen above, Nolan points out that the beneficiary's proprietary right is the negative right to exclude non-beneficiaries. According to him, this is the central feature of the beneficiary's proprietary right. However, it is submitted that two related problems arise from Nolan's analysis. The first is that in a breach of trust, the beneficiary's right goes beyond the negative restrictions on third party interference. The second problem, which follows from the first problem, is that because a different right arises in favour of the beneficiary when the trust property is misapplied, beneficial ownership may be said not to be a 'real right' in the normal sense. These problems will be examined below. The conclusion is that irrespective of the rule adopted by English law, beneficial interest may be a different type of property right, or real right in English law, implying that the idea of 'full ownership' may not fit in well.

As already stated, Nolan argues that the core proprietary character of beneficial ownership may be conceptualised as a negative right, which binds non-beneficiaries from interfering. However, it is submitted that this explanation does not provide sufficient ground for how a new, positive right is set up when trust property is misapplied. For instance, where trust property is misapplied,[459] English law generally imposes a positive obligation on the bad faith purchaser to hold the property in constructive trusteeship for the beneficiary.[460] The constructive trust is fundamentally seen as resulting from a new set of positive obligations different from the earlier (negative) right in the initial trust. [461] Nolan's analysis therefore does not explain how this comes about. As already stated, Nolan simply suggests that the beneficiary's core proprietary right is the negative obligation on non-beneficiaries not to interfere. However, the above on constructive trust shows some faults with this argument.

The second problem is that a beneficiary's claim to a misapplied trust asset is based on a new right. It may be assumed that if the beneficiary's right is a real right, the right ought to be the same regardless of the party in custody of the asset. However, this is not the case: where a trust asset is misapplied, the beneficiary, as seen above, relies on a different set of (positive) rights to vindicate his rights in the property.

Civil law, in contrast to English law, has a different approach. Where an asset is unlawfully removed from the custody of its owner, the obligation to return the property to the owner has the same basis. The content of the obligation is the same regardless of the party in possession. Consequently, where the possessor transfers the property to a successor, the vindicatory obligation to return the property may no longer be exigible against the earlier possessor but remains the same against the subsequent successor. Regardless of this, the obligation, in Civil law, is the same regardless of the party in possession.

The contrasting approaches between English law and Civil law systems may suggest that beneficial interest is *not* a 'real right'. Essentially, a real right is a right which moves with the asset irrespective of the party in possession. As seen under the Civil law, the owner's right in the thing is the same and moves with the asset. However, for a trust, while the beneficiary's interest is conceptualised as a negative right in the earlier trust, a new (positive) right is created

[459] Where the third party aided the misapplication but the trust property was not vested in him: in this case, a personal action may be brought against him to account as a fiduciary. A constructive trust only arises where the trust property has been vested in a bad faith third party. Jill Martin, *Hanbury & Martin Modern Equity* (18th edn, Sweet & Maxwell Ltd 2009) para 12.005.
[460] *Boardman v Phipps* (1964) 2 ER 187; *Guinness Plc v Saunders* (1990) 2 AC 663.
[461] Bridge and others (n 310) paras 31.017-31.025. The reason for this is that the third parties are strangers to the earlier trust.

when the asset is misapplied. Essentially, a new right is created upon misapplication, with the effect that the beneficiary relies on a different set of rights against each successor of the trust property.[462] This may suggest that beneficial interest is not a real right; what is generated is a personal right exigible against the successor of the trust property.

Some counter-arguments may be made against the above analysis. First, it may be said that beneficial interest is a type of 'ownership' under English law. [463] Additionally, it may further be said, as Nolan argues above, that beneficial interest is one type of a 'right *in rem'* conceptualised as a negative right of non-interference. These views may be justified when seen within the more specific English law doctrinal context. Because beneficial interest, under English law, has third-party effects, it is seen as a right *in rem*. This second view may not be fool-proof if, as Gretton notes, it does not follow that a right is a real right because it is directed at third parties. Third parties may be liable under a contract on grounds of collusion.[464]

However, the English law approach may be sustained when seen from a historical perspective. The approach provides an example of how English law develops in 'baby steps' from a focus on practical results to a subsequent conceptualisation of issues from first principles. As Gordley notes, it was not until the 19th century when English lawyers became concerned about identifying broader principles from the decisions of the courts.[465] It was only from that period that they first attempted to deduce certain general principles and then explained results with the aid of those general principles which at times were adopted from Civil law.[466] Tarrant similarly notes that it was only with the publication of John Austin's book in 1863, that the concept of *right in rem* was adopted in English law.[467] Therefore, it may be said that Nolan's recent conceptualisation constitutes an attempt to explain the results of an established trust arrangement within the general conceptual framework of real rights. The contrary views against Nolan's opinion may likewise be an attempt to rebut those views with a similar conceptual method. However, because the trust arrangement may have developed in a practical rather than a methodical way, it may not suitably fit into already established patterns of real rights which Tarrant notes was borrowed from Civil law.

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[462] There is therefore the risk of infinite regression. A new right is created each time the trust property is transferred from one successor to another.

[463] *Re Transphere Pty Ltd* (n 451) 311, where the court held that beneficial ownership is a kind of 'equitable estate' in property.

[464] Gretton, 'Trusts without Equity' (n 306) 602.

[465] See James Gordley, *The Jurist: A Critical History* (OUP 2013) 27; see also Roger Cotterell, 'English Conception of the Role of Theory in Legal Analysis' (1983) 46 MLR 681.

[466] Gordley (n 465) 27. Gordley notes that it was not until 1865 when the English courts, in Asher v Whitlock (1865) 1 LR became concerned with whether they were protecting 'ownership' or 'possession'.

[467] Tarrant (n 307) 678.

As seen above, this attempt at conceptualisation may be faulted on the ground that beneficial interest may not be a real right properly so called. However, this does not generally disprove the fact that English law achieves a similar effect with a different normative structure. In essence, beneficial interest may be a type of 'ownership' or 'property right' under English law which may be understood differently from the normal rights *in rem*.

Within the broader context of the functional method, the above contrasting conceptual underpinnings of both Civil law ownership and English law beneficial interest may not matter significantly if they have the same effects. On the one hand, in beneficial interest, as already noted, equity imposes a positive obligation on bad faith successors to hold the property for the benefit of the beneficiary. This new obligation on the successor is not different from the earlier obligation imposed on the trustee to hold the trust asset for the benefit of the beneficiary. The right achieves the same purpose as a normal real right, i.e. to allow the beneficiary to vindicate its claims to the property. Similarly, in Civil law the same result is achieved, but with a different conceptual tool. The right follows the asset regardless of the successor. Thus, both the Civil law and English law will seem to provide functionally similar solutions in terms of the vindicability of the right.

However, that a right can be vindicated alone does not erase the fact that these institutions are different in other aspects, even when seen functionally. This raises questions regarding the criteria to be used to arrive at any decision as to whether the institutions are equivalent or not. Do we do away with the differences? Or rather are the differences part of a larger institutional framework? It is more likely that the institutions can only be seen within a doctrinal framework, since third party effect, for example, as further demonstrated in the next chapter is not, on its own, a true test of a property right.

5.4.5.2 Beneficial interest as a primary real right (title transfer) or security right (security arrangement)

From the above analysis, it seems that beneficial ownership is a type of real right under English law. However, the related question here is whether it qualifies as a real right of ownership or a subordinate real right for the purpose of the Directive. This issue is important when seen in the light of the distinction between SFCA and TTFCA, which both give rise to real rights.

As discussed above, Nolan admits that beneficial ownership may not be 'true ownership' but may be a real right. It is important to note that it is not all real rights that are

ownership rights. Ownership is a real right, but it is not the only real right. In English law, there are other property rights, such as charge, lien, mortgage and pledge. These rights are real rights but not ownership.

The distinction above is important when seen within the context of the Directive. As noted, both a TTFCA and an SFCA give rise to real rights, but the proprietary interest in both are different. While in the former, 'full ownership' is transferred, a security right (limited real right or security interest) is created in the latter. If Nolan's conclusions are to be accepted, i.e. that beneficial interest is not ownership but a subordinate real right (i.e. limited right), it therefore implies that beneficial ownership, being a real right less than ownership, may be categorised as SFCA discussed in chapter eight.

5.4.5.3 Fragmentation of interest in a trust and 'full' ownership in the Directive

The issue is whether a trustee or beneficiary can be said to have 'full ownership' within the definition of a TTFCA. This phrase will indicate an exclusive right vested in a person. As previously discussed, Nolan points out that in a trust, ownership is fragmented between the beneficiary and trustee. This indicates that ownership is divided in a trust, therefore leading to problems as to whether the proprietary rights in a trust may appropriately qualify as 'full ownership' as provided by the Directive.

Nolan argues that the 'creation of many and varied interests under a trust may mean that no particular person can claim to hold the full panoply of rights known as 'ownership' if that term is understood to mean a right of exclusive enjoyment.[468] He contends that a trust simply fragments' the rights in the property between a trustee and the beneficiary meaning no one person can have ownership.

However, it may be inaccurate, as Nolan does, to speak of fragmentation of rights as if the beneficiary's right was 'caved out' or 'separated' from the legal title of the trustee, who is seen as the owner of the property.[469] The argument may be made that the law only recognises one 'title', that is, the trustee's title to exclusive possession.[470] This means that the trustee does not have both the legal and equitable title in the asset, from which the beneficiary's equitable

[468] Nolan (n 374) 258.
[469] Swadling, 'Property: General Principles' (n 453) paras 4.145-4.151.
[470] ibid 4.148.

interest is then carved out. The trustee has the sole legal title in the property to possession.[471] The beneficiary's right may best be described as an equitable right to 'compel the legal owner [trustee] to hold and use those rights which the law gives him in accordance with the obligation which equity imposed on him by the existence of the trust'.[472] The beneficiary interest may therefore not be a title caved out of the trustee's right. His right arises from an obligation imposed by equity on the trustee to use the assets for his benefit. The right is sometimes described as having been 'impressed' upon the trustee's title,[473] or rather 'grafted onto it' by equity.[474] In effect this means that the trustee is the sole owner of the trust property, while the beneficiary's right may constitute a personal burden on the trustee compelling him to use the assets in accordance with the obligation imposed on him.

It is possible that the above conclusion is premised on how the common law defines title. As earlier noted, title under the common law refers to the exclusive right to possession. This means that the title vested in the trustee cannot, at the same time, be vested in the beneficiary. If the trustee has the title to exclusive possession, the beneficiary cannot be vested with the same right; possession is indivisible.[475] Consequently, at any given point in time, only one party can have possession of the property, i.e. the trustee, who is treated as the owner under the common law. The indivisibility of possession makes it impossible to conceive of a separate right to the same asset.

The above point suggests that it is questionable whether a trust fragments the rights. It will appear that the sole title to the property is vested in the trustee, and there is an obligation under equity to compel the trustee to use the property for the beneficiary's benefit.

One thing issue still missing in the above analysis is insolvency and possible inclusion of the trust asset in any judicial execution. If the trustee is assumed to have title, it is normally expected that the property should be available to his creditors. In the trustee's insolvency, the

[471] It is said that the trustee's title is that of a 'bare legal owner' rather than an absolute or 'full owner', because he holds the property for the benefit of the beneficiary. However, it is suggested that the term 'bare legal owner' connotes that something has been removed from the legal title. This will accord with Nolan's analysis on fragmentation. However, see *DKLR Holding Co (No 2) Ltd v Commissioner of Stamp Duties* (1982) 149 CLR 431, 474, an Australian case where it was held that the beneficiary's interest is not caved out or removed from the trustee's title. See also Tobias Barkley, 'Trustees' Bare Legal Title: Concept or Misconception?' (2017) 26 Australian Property Law Journal 44, 47.
[472] *Re Transphere Pty Ltd* (n 457) 311.
[473] *DKLR Holding Co (No 2) Ltd v Commissioner of Stamp Duties* (n 471) 474.This may falsely mean that it is a burden on the trustee's interest, with the trustee retaining the residual right. However, see McKendrick (n 305) 44 who notes that equitable interest may be an absolute interest.
[474] Barkley (n 471) 44.
[475] Bridge (n 313) 37.

asset ought to be liquidated and applied in satisfaction of claims to the trustee's creditors. However, this is not the legal position. The law is that in the insolvency of the trustee, the trust property does not form part of the trustee's estate.[476] It is totally excluded from the trustee's property. One striking fact about this is that there is no access to the property at all by the insolvency administrators. A normal subordinate real right will normally fall into the insolvent estate subject to the right. But with a trust property the asset is completely excluded. The question is on what basis is the beneficiary's right protected in insolvency?

One view may be that insolvency does not undermine the trustee's title. Regardless of the insolvency arrangement, the trustee remains the owner. On the other hand, it may also be argued that this takes us back to the concept of relativity of title. Within insolvency, it may be taken that the beneficiary has a better title. Overall this may suggest that English law indeed does not have a concept of full ownership, but deals only with priority of entitlement, as highlighted earlier.

Consistent with the foregoing, if it is taken that the trust indeed fragments 'ownership' or 'property rights' in the asset between the trustee and the beneficiary, the implication is that no one has 'full ownership' within the context of the Collateral Directive. As highlighted previously, the Collateral Directive defines a TTFCA as the transfer of 'full ownership' to the collateral taker. If these terms are taken to refer to the right of any person to hold the full panoply of rights and have exclusive enjoyment to the property, then, based on Nolan's analysis, neither a trustee nor a beneficiary may be said to have full ownership in the property within the context of the Directive, since the trust fragments the interests between them.

It is striking to compare this with the Civil law approach. In Civil law, it will not be difficult to say that the 'trustee' has full ownership while the beneficiary has a limited real right in the same property. Even where the two real rights are held in the same asset, full ownership may still be transferred but subject to the beneficiary's limited right in the trust asset. However, with a trust, the idea of co-existence is much difficult when the idea of equitable interest is recognised.

[476] See Insolvency Act 1986 , section 283(3)(a), This section applies to individuals who are bankrupt, but applies by 'analogy' to companies. See Swadling, 'Property: General Principles' (n 453) para 4.152.

5.4.6 Ownership incidents as relative solutions

Unlike Civil law, which recognises a concept of ownership, the discussion above reveals that English law takes a 'relational' approach.[477] The concept is relative in the sense that the recognition of ownership is dependent on who either has a better right to possession under the common law or perhaps who has priority between two beneficial owners. In a trust, ownership is also relational between the trustee and beneficiary.

From the foregoing, it is trite that English law, especially in relation to beneficial interest, does not have a concept of ownership either in terms of equivalent effects as seen in Civil law, or as a doctrinal concept . However, the absence of a concept of ownership does not mean, as seen above, that some of the normative consequences commonly attributable to ownership do not arise. For a common law title holder, the rights are present. On the contrary, for the beneficiary, some of the rights are missing, especially the positive rights. This raises questions regarding whether we can arrive at a system-neutral meaning based on just rights which are similar? If we are to use only the negative rights, what about the positive rights which are missing in beneficial ownership? This suggests that these criteria may themselves hide preference for Civil law ownership and its conceptualisation into positive and negative rights, as opposed to the position in English law.

5.5 Financial Collateral Directive and presuppositions of full ownership

The previous section examined how the Common and Civil law broadly understand the concept of ownership. In the discussion below, we will consider how the Directive casts the concept.

As mentioned, a TTFCA is defined in the Directive as the transfer of full ownership to the collateral taker. On the surface, the term denotes a concept of full ownership which may not be difficult to locate in Civil law unlike English law. However, the Directive is meant to have 'equal status'[478] across the Member States and is deemed to have equal authenticity with the same legal effects.[479] This means that it ought to have a uniform application. As such, it is necessary to find a stable meaning of 'full ownership' which can apply across the systems. However, although the Directive does not explicitly define the concept, we may consider other

[477] Wolfgang Faber, 'Scepticism about the Functional Approach from a Unitary Perspective' in Wolfgang Faber and Brigitta Large (eds), *Rules for the Transfer of Moveables: A Candidate for European Harmonisation or National Reform?* (Sellier European Law Publishers 2008) 99, footnote 8.
[478] Gretton, 'Financial Collateral' (n 263) 215.
[479] Doczekalska (n 241) 13.

provisions of the Directive to distil any implicit analytical presuppositions. Reference will also be made to the legal effects of a TTFCA, such as repo or securities lending arrangements, to understand what the term "full ownership "presupposes.[480]

As discussed in the previous chapter, a TTFCA is used as a means of evading the onerous publicity requirements for the constitution of a security device. Because ownership is transferred outright in a TTFCA, the collateral taker has the right to use the collateral in any way it deems fit.[481]

Market participants, in adopting a TTFCA, exploit the distinction between ownership and a security right.[482] The transfer of ownership is the justificatory strategy for the legitimisation of such a transaction. However, this explanation is unclear. It does not explain the consequences of ownership within the transaction. On the surface, it only describes why the law recognises such transactions. The legal materials on this issue are similarly not helpful. The term 'ownership' is used widely without any analysis of its effect. This assumes a wide recognition that financial collateral are dematerialised property capable of ownership. For this reason, there seems to be the widespread reference to ownership terminologies,[483] such as the 'right of use', enjoyment of benefits and burdens of ownership. Collateral, or personal rights, are therefore reified as assets, making it easy to apply ownership terminology to the holding of financial collateral. The reification of financial collateral as an asset facilitates the widespread usage of ownership terms. The normative consequences which follow from the concept are thus flexibly applied by implication.

The opinion is that a TTFCA performs two functions: a recovery function and a tradability function. [484] It is important to note that an SFCA also performs a recovery function but in a different way. However, what distinguishes a TTFCA from a SFCA, as discussed in

[480] See paras. 13 (c) and 14 (c) of GMSLA, 2010 version and para 6 (e) of GMRA 2011 version.
[481] Thomas Keijser, 'Report on a "Right of Use" for Collateral Takers and Custodians (Presented to the UNIDROIT Secretariat)' (2003) 3 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2859436> accessed 25 March 2017.
[482] Wood (n 270) 675.
[483] IOSCO, 'Securities Lending Transactions: Market Development and Implications' (1999) 66 <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD96.pdf> accessed 13 May 2017; Benjamin (n 258) para 6.09; International Capital Markets Association, 'What Is Rehypothecation of Collateral' <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateral-markets/frequently-asked-questions-on-repo/10-what-is-rehypothecation-of-collateral/> accessed 14 May 2017.
[484] Keijser (n 96) 16–19; Wood (n 270) 673–675, 684; Benjamin (n 258) paras 6.10-6.13; Edward Murray, 'Financial Collateral and the Financial Markets' in Frederique Dahan (ed), *Research Handbook on Secured Financing in Commercial Transactions* (Edward Elgar 2015) 158,163. Erica Johansson, 'Reuse of Financial Collateral Revisited' in Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities: Legal Problems and Practical Issues* (Hart Publishing 2010) 153.

chapter nine, is the tradability function.[485] The tradability function, as seen below, is the key characteristics of full ownership in the Directive. The recovery function describes the transfer of ownership from the economic perspective of minimising credit risk, rather than the internal aspects of the property right. Nonetheless we will look at the two functions below.

Recovery function means that the financial collateral is used by the collateral taker to safeguard against the collateral provider's default. Primarily, TTFCAs are used for 'recourse' reasons. [486] This principally means that the recovery function is predicated on the debt side of the arrangement, that is, where the collateral provider is unable to discharge the relevant obligation, the collateral provider may use the collateral to discharge the debt.

Benjamin points out that in a TTFCA, the 'credit risk of the collateral taker is addressed by its outright ownership of the collateral'.[487] This primarily means that the credit exposure of the collateral provider is covered by the outright transfer of ownership to the collateral taker. This function does not look at the features of the property right created but looks at the security motive behind the transaction. In this light, it is important to state that market participants make efforts to ensure that the transaction is not seen simply as performing a recovery function. This may attract the recharacterisation risk, discussed in the previous chapter. In sum, the recovery function simply tells us that the collateral is used to secure a debt.

A TTFCA also performs a 'tradability function' as earlier mentioned. This is taken as the key indicator of what amounts to a TTFCA and possibly what qualifies as full ownership. It does not just refer to the right to transfer the collateral, since the collateral taker can create a security right without transferring the collateral. The function is important because it enhances market liquidity; it allows a collateral taker to enter into further trading. Additionally, the tradability function of TTFCAs is more pronounced in securities lending arrangements under which stocks or securities are borrowed to cover short positions.[488] The motive is to make some gains from the price fluctuation. Importantly, the tradability function is an essential element of this transaction, since the borrower of the securities obtains the securities for the motive of on-lending it or selling it.

[485] This distinction has been erased by the Directive which vests in a collateral taker the right of use in an SFCA .
[486] Keijser (n 96) 16,72.
[487] Benjamin (n 258) 6.09.
[488] Wood (n 270) 29.

As mentioned, the tradability function primarily refers to the right of the collateral taker to use the collateral. In legal terms, the right refers generally to the unlimited right of the collateral taker to dispose of the collateral or create a further security right for his own benefit in the collateral.[489]

In the markets, a distinction is usually made between a right of use which is vested in the collateral taker because of his outright ownership of the collateral, and a right of use (i.e. right to Rehypothecate)[490] which is vested in a collateral taker under a security device. The former is understood to be automatically vested in the collateral taker by the transfer of ownership under a TTFCA. Therefore, because the collateral taker is the owner of the collateral, it is therefore vested with the right of use. However, in an SFCA, the right must be expressly 'granted' to a collateral taker by a contractual term. It does not automatically 'vest' in him by the transfer of ownership. Technically, the distinction between 'grant' and to 'vest', within this context, reflects the property right conferred. In an SFCA, a security right is created hence any right to dispose of the collateral must be contractually granted by the collateral provider, who is deemed to remain the owner. However, for a TTFCA, the transfer of the right of ownership automatically vests the right of use or tradability in the collateral taker. [491]

The tradability function, or right of use, in a TTFCA is normally thought of in an unrestricted sense. Underlying the tradability function is the general presupposition that the collateral taker has the exclusive right to deal with the collateral. Essentially, this implies that he enjoys all the powers, rights and exclusive enjoyment in the collateral and may deal with it in any way he deems fit as owner. However, that the collateral taker is expected to trade the collateral is not a mandatory expectation. The collateral taker may decide not to trade the asset but to retain it for any reason or for its own use. He may also decide to destroy it, or exercise other normal rights. In short, he may be deemed to have the exclusive right of enjoyment normally vested in an owner. [492]

The submission may be made that the tradability function does not just presuppose a positive power to trade or use the collateral. It also presupposes that the collateral taker may

[489] Keijser (n 96) 174.
[490] Johansson (n 484) 152, footnote 3. Rehypothecation refers to the use of the collateral by the collateral taker for its own purpose.
[491] The above distinction explains why the Directive, in article 5, stipulates that a right of use must be agreed in an SFCA. There is no similar provision for a TTFCA because of the assumption that the transfer automatically vests such a right.
[492] Keijser (n 481) 3. Keijser implies that the right is synonymous with a right of disposal. However, he also notes that TTFCA confers on the collateral taker the right to use the collateral 'as he deems fit' as owner. This will suggest an unlimited or exclusive right to the collateral.

decide not to trade the collateral or generally take other alternative decisions which are all vested in an owner: i.e., the right to enjoy the collateral, use it for its own use or other uses, dispose of it, exclude everyone from it, etc. It connotes both the negative right to exclude others, as well as the positive rights to enjoy, use, dispose, destroy, trade, etc. the collateral. This conclusion is similar to the presuppositions of full ownership employed in the market, or particularly in the Directive.

Applying the above meaning to the terms 'full ownership' in the Directive, certain deductions can be made. As previously mentioned, the word 'full ownership' is not a 'statement of fact' but a 'conclusion of law'. [493] On the surface, it denotes a unitary right of ownership, or a unitary concept with normative consequences. The tradability function, as seen above, may be said to confirm this presupposition. The function, as seen above, connotes an exclusive right vested in an owner to deal with the collateral, either to trade it, or alternatively not to trade it, or to dispose of it, or create another security right in the collateral, or use it for another purpose as generally may be determined by the owner.

This presupposition resembles closely Civil law ownership contrasts with 'ownership' in English law. In Civil law systems, as previously seen, there is a clear unitary concept out of which certain normative consequences follow. The owner also has the full exclusive rights of enjoyment of the asset. It is therefore not difficult to conclude that ownership under the Civil law appropriately matches ownership as presupposed by the Directive. However, for English law, there is no clear concept of ownership if that term is taken to refer to a conclusion of law or a concept with clear boundaries, as already discussed.

5.6 CONCLUSION

This chapter investigated the nature of ownership, highlighting the concept's treatment under Civil law but most especially English law. The core argument is that contrary to what is presupposed by the Directive, there is no concept of full ownership in English law. Although both English law and Civil law, in some instances, do give rise to equivalent results, it would be wrong to conclude that all their effects are equivalent or that English law normatively has a concept of ownership because certain criteria (such as insolvency protection and third-party effect) are present. On their own, these effects, as discussed, do not indicate that an interest is an ownership interest. First, the insolvency protection may be based on some legislative choice

[493] HLA Hart, 'Definition and Theory in Jurisprudence' (1954) 70 LQR 37; see also Cohen's response to Hart: Jonathan Cohen, 'Theory and Definition in Jurisprudence' (1955) xxix Proc Aristotle Soc. Suppl. 213, 215. Both Hart and Cohen agree that terms such as 'right', 'duty' and 'possession' are not statements of fact but conclusions of law.

which arises from the idea of relativity; secondly, the third-party effect is not self-evidently an ownership right, since personal rights are likewise directed at third parties. It could also be that the third-party effect means it is a limited real right (SFCA). Besides, as demonstrated in the chapter, that the beneficiary's right is not defined in terms of its positive contents buttresses the fact that it is not an ownership right.

The conclusion which may be drawn from this is that although some criteria or effects may be equivalent, some others, as mentioned above, are not. Attempting to define an institution based on certain criteria at the expense of others may hide a bias for similarity or some other subjective preference, as demonstrated earlier in relation to Rahmatian's position and the provisions of the Directive which wrongly apply Civil law criteria as if they are clearly self-evident. The reason why this may be the case is because the Directive, when applying a functional methodology, attempts to reconstruct different domestic institutions in the presumption that they share common qualities. However, the argument here is that such an approach is particularistic: it rejects that there are doctrinal principles on which rules are founded. Ironically, although it rejects doctrine and formalism, but as Michaels suggests, the approach is itself formalistic [494] , which as seen in the case of the Directive endorses one idea of ownership at the expense of other types of property rights.

[494] Michaels (n 1) 372.

6 CHAPTER SIX: PERSONAL RIGHTS AS OBJECTS OF REAL RIGHTS AND ENTITLEMENT

6.1 INTRODUCTION

The previous chapter considered the meaning of full ownership as used in the Collateral Directive. In this chapter, we will consider whether this concept can be used in relation to financial collateral which are conceptualised as incorporeals in Civil law, or choses in action in Common law.

Incorporeals or choses in actions are intangibles. One implication of this is that they are legal fictions or abstractions.[495] Another name for them is 'right'.[496] They arise from obligations from a contract giving rise to the payment of a debt (or claims to such payments)[497] or from delictual liability.

Art 2 (1) b of the Directive defines a TTFCA as an arrangement under which a collateral provider transfers full ownership of, or full entitlement to, financial collateral to a collateral taker. This provision seems to endorse the view that financial collateral can be the object of ownership. However, among property law theorists and doctrinal writers, this view is controversial. On the one hand, modern property law theorists, such as Penner,[498] Waldron.[499] Honoré[500] and Harris,[501] seem to agree that claims can be the valid object of real rights. As we will see below, their views seem to be premised on a common denominator: that property law principles apply to incorporeals, thus they are objects of ownership. On the other hand, among property law doctrinal writers, the picture is not clear. First, there are those that restrict ownership to corporeal things. These writers, both under Common law[502] and Civil law[503] share similar viewpoints with the Pandectists under German law, who restrict ownership to physical

[495] MacCormick (n 63) 136.
[496] Reid (n 307) 230. Though not all incorporeal things are rights: for example, gas is incorporeal, but it is not a 'right'.
[497] Obligation has an active and passive side. The active side refers to the creditor's personal right to performance from the debtor (i.e. claim). The passive side is the debt from the debtor. Erp and Akkermans (n 330) 368; Andreas Rahmatian, 'Money as a Legally Enforceable Debt' (2018) 29 European Business Law Review 205, 209.
[498] Penner, *The Idea of Property* (n 367) 105–127.
[499] Waldron (n 369) 27–58.
[500] Honoré (n 18) 128–134.
[501] JW Harris, *Property and Justice* (OUP 1996) 50.
[502] Arianna Pretto-Sakmann, *Boundaries of Personal Property:Shares and Sub-Shares* (Hart Publishing 2005) ch 4,8,10; McFarlane (n 431) 4.
[503] Gretton, 'Ownership and Its Objects' (n 307) 805–851.

things.[504] In a separate category,[505] there are also many others such as Rahmatian,[506] Reid,[507] Sjef van Erp[508] and Benjamin[509] who endorse the view that claims can be the valid object of a real right. These authors generally share some views with the theorists.

These different opinions have different implications for the Collateral Directive which appears to endorse the view that claims can be the valid object of a real right. It endorses this view as if it is a system-neutral fact applying across systems. Importantly, to understand the effects of the debates to the formulation in the Directive, it is important to examine the opinions of the above authors to distil their individual consequences on the legislative process of the Directive.

However, it is important to note that the discussion in this chapter needs to be seen within the broader context of the functional method which presupposes that legal institutions can be defined in a system-neutral way, based on their functional effects. Therefore, the question is whether the idea in the Directive is indeed system-neutral.

As the discussion below will demonstrate, different conclusions may be distilled from applying the various opinions to the Directive. First, it may be that financial collateral can be the object of ownership. This will accord with the formulation in the Directive. In this regard, it is the responsibility of the different systems, such as Germany or the Netherlands, to fit that conclusion into their systems.[510] Second, it is also possible that the provision endorsed by the Directive is wrong, because financial collateral cannot be owned. The object of ownership is a physical thing, not a right. Third, it may be that it is ultimately a matter of convention how systems choose to characterise the issue of ownership of claims, in which case there is no single

[504] The most dominant of this view is proffered by the Pandectists. Their influence can be seen in the German Civil Code. A summary of their views can be found here: Francesco Giglio, 'Pandectism and the Classification of Things' (2012) 62 U Toronto LJ 1, 1–20; Mincke (n 304) 78,80-84; Gretton, 'Ownership and Its Objects' (n 307) 806. Gretton acknowledges his views are influenced by the Pandectist's approach.

[505] Rahmatian takes a systematic approach, hence attention will be paid to him, although the views of other authors, such as Benjamin and Reid, will be highlighted to show support for this second view.

[506] Rahmatian's views appear in series of his works dealing with intellectual property rights, debt and money: Rahmatian, *Copyright and Creativity* (n 309); Rahmatian, 'IP and Dematerialised Property' (n 20); Rahmatian, 'Debt' (n 497).

[507] Reid (n 307) 225.

[508] Sjef van Erp, 'Deconstruction and Reconstruction of European Property Law: A Research Agenda' in Eleanor Cashin-Ritaine (ed), *Legal engineering and comparative law/L'ingénierie juridique et le droit comparé. Rapports du colloque du 25e anniversaire de l'Institut Suisse de Droit Comparé du 29 août 2008 à Lausanne* (Schultess 2009) 105.

[509] Benjamin (n 258) ch 13.

[510] In German and Dutch law, incorporeal things cannot be the object of ownership. See § 90 and 903 of the *Burgerliches Gesetzbuch* (German Civil Code); see also § 3.2 and 5.1 of the *Burgerlijk Wetboek (BW*) (Dutch Civil Code).

answer to the question: the German system may have solutions different from English law. This may presuppose there is no system-neutral idea, since it is a question of convention on how the issue is characterised. This last point may be the idea behind the concept of 'full entitlement', which is used in the definition of a TTFCA. It will be argued that this phrase 'full entitlement' is used to accommodate systems which do not recognise ownership of collateral.[511] However, there are presuppositions in the Directive that the content of full ownership and full entitlement are equivalent, presupposing that they are equivalent concepts. The chapter will consider if this is accurate.

In examining these issues, the chapter is divided into three sections. The first considers the modern theories of Penner, Honoré and Harris. Waldron writes very little on the issue, thus his views are only briefly highlighted. The second section considers the doctrinal positions of the Pandectists, Gretton, Pretto-Sakmann, Rahmatian , Benjamin and, summarily, Reid's. The last section looks at the effects of the various theories and views on the Collateral Directive.

6.2 PROPERTY LAW RULES AS APPLICABLE TO CLAIMS

Regarding whether claims are valid objects of ownership, modern theorists can be divided into two categories. The first category includes theorists like Penner, who has explicitly defended the idea and has set out an elaborate theory in support. This contrasts with theorists in the second category, making up the majority, such as Waldron, Honoré and Harris who, although accepting the idea that claims can be the object of a real right, are slightly tentative in their responses. For example, Honoré sceptically notes that the incidents of ownership, highlighted in the previous chapter, are naturally applied to material things than to incorporeal rights, [512] and even where they apply to incorporeals they apply by 'analogy'.[513] This suggests that we first need to identify the incidents/concept of ownership as they relate to corporeals before applying those concepts to incorporeals. Waldron likewise shares this scepticism. He notes that corporeal resources are of 'primal and universal' concern of human societies unlike incorporeals which cannot be regarded in the same way.[514] As such, in his view there are valid reasons to address the questions about ownership of material things first before confronting questions about ownership of incorporeal things, which arise only because 'other more elementary questions (including questions about the allocation of material objects) have been

[511] See EC, 'Proposal for Amendment', para 6.2.2.
[512] Honoré (n 18) 129.
[513] ibid.
[514] Waldron (n 369) 34.

settled in certain complex ways'.[515] Harris equally gives prominence to tangible assets. He notes that the 'law takes an intangible thing and builds around it a property structure modelled on the structure which social and legal systems have always applied to some tangible things'.[516]

The above opinions, especially Waldron's, hints that incorporeals were less important compared to material things. But this view is debateable in modern times, since as noted by Mr Justice Briggs in *Re Lehman Brothers International (Europe) (in Administration))* 'intangibles are […] the very stuff of the modern financial collateral'. [517] In this sense, they share equal importance to tangible assets, especially to investors in global financial markets, who, as also noted by Moss, will be concerned if such assets were not capable of being objects of real rights.[518] Essentially, the modern importance of these objects suggests that it is a self-evident idea that incorporeals are the objects of real rights. In fact, this seems to be a widely accepted view even to the public.

Notwithstanding the scepticism shown by these theorists, Honoré, Waldron, and Harris agree that incorporeals are valid objects of real rights. However, the prominence which they give to corporeal things means that any discussion on the ownership of claims is restricted to the background – although Penner is an exception as seen below.

Penner offers a more elaborate theory (i.e. 'separability thesis') regarding the objects of real rights without any distinction regarding the characteristics of the object. However, as seen below, the reason why Penner does not distinguish is because his theory offers a justificatory account for objects of real rights in English law: English law generally accepts that both corporeal and incorporeal objects can be the object of property rights. Penner's analysis therefore starts from this presupposition and then offers an abstract justification for the object of property right in English law. Therefore, he takes it as read that both real and personal property, at an abstract level, can be justified by the same principles (i.e. separability thesis).

Rahmatian, whose views are discussed below, may disagree with Waldron, Harris and Honoré. He may argue that historically " the abstract conceptualisation of 'objects of property'

[515] ibid.
[516] Harris (n 501) 44.
[517] *Re Lehman Brothers International (Europe) (in Administration))* [2012] EWHC 2997 (Ch) [131].
[518] Gabriel Moss, 'Intermediated Securities: Issues Arising from Insolvency' in Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities: Legal Problems and Practical Issues* (Hart Publishing 2010) 65.

has existed for a long time'.[519] According to him, indications of that idea can be found in Bentham, Lord Kames (the Scottish jurist and philosopher) , and the English idea of the Estate, which developed out of the abstract notion of tenure before the eighteenth century.[520] Thus, Rahmatian, like Penner, may suggest that it is not necessary to differentiate between corporeal and incorporeal things or, to argue, as Honoré does, that property law principles apply to incorporeals by way of 'analogy'. Rahmatian may instead contend, as discussed below, that real rights apply in the same way to both corporeal and incorporeal objects, since the materiality of the asset has never been important for the law.

Two initial observations may be made regarding the views of the theorists. First, their views indicate that the question whether claims can be the object of real rights is not straightforward. This is obvious even among theorists who endorse the idea, such as Honoré, who argue that the ownership concept applies by 'analogy' (rather than directly) to claims. In fact, Rahmatian agrees that possession, which is a legal concept aligning very closely with ownership, does not apply to incorporeals, thus indicating the late development of the concept of real rights in relation to incorporeals.[521] Secondly, the approach adopted by these theorists suggests that it is not difficult to know their conclusion straightway: that is, because property law concepts, such as that on transfer, apply by analogy to incorporeals, they are thus valid objects of real rights. As we will consider later in this chapter, there is a circularity in this argument.

As noted, Penner provides a detailed argument in support. He starts off by pointing out that while debts and claims are 'undoubtedly property', [522] however, unlike rights in material things which are rights *in rem*, debts give rise to rights *in personam*.[523] He adds that this right is not just there in the world, [524] because they arise as a result of personal dealings between people. He notes that it will therefore seem that the personal relation is an essential part of the debtor/creditor relationship for debts.

[519] Rahmatian, *Copyright and Creativity* (n 309) 11.
[520] ibid. Rahmatian refers to: Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation* (Oxford Clarendon Press 1907); Andreas Rahmatian, 'The Property Theory of Lord Kames' (2006) 2 Int'l Journal of Law in Context 177, 185.
[521] Rahmatian, *Copyright and Creativity* (n 309) 11; see Carol Rose, 'Possession as the Origin of Property' (1985) 52 University of Chicago Law Review 73. She argues that possession is the origin of property.
[522] Penner, *The Idea of Property* (n 367) 115. He can only be thought to be referring to English law.
[523] ibid 107–108.
[524] ibid 115.

Penner goes on to formulate what he describes as the 'separability thesis' to argue how claims acquire their property-like character, even though they are based on a personal right. According to him, the property-like character of claims and choses in action can be explained by the fact that they are 'contingent' to the creditors/owner. Penner argues that 'only those things in the world which are contingently associated with any particular owner may be objects of property [….]'[525]He adds that as a function of the nature of this contingency, in theory nothing of normative consequences beyond the fact that the ownership has changed occurs when an object of property is alienated to another. In this way, Penner thus separates a person's talent, from rights which are property because of their contingency to the owner.

However, other rights arising under a contract, for example, a contract of employment, or rights to damages arising from delictual liability, will fall under this contingency test, since a person does not 'necessarily' have a contractual right or rights to damages.[526] On this point, Penner is quick to point out that what distinguishes a property right is not just that they are contingently ours but that they might just as well be someone's else's.[527] Therefore, the 'contingency of our connection to particular items of property is such that, in theory, there is nothing special about my ownership of a particular car – the relationship the next owner will have to it is essentially identical'.[528] Thus in contrast to choses in action, a right under a contract of employment, or a right to damages is personal to the contract: 'the obligation is not separate from the person who has it [….]'[529] For example, in the case of the contract of employment, 'the labour involved is an aspect of the employee's personal experience, the act of an agent [is] not some free-standing "thing" which can be stripped away from him'.[530]

On the premises of the foregoing point, Penner argues that the separability thesis emphasises the independent identity of the owner, as well as the independent identity of owning the thing. Thus, the owner must still be the same person if he no longer has the thing, even when it is taken from him; and, also, where a different person takes the thing, the person must stand in the same position with the thing as the first person.[531]

[525] ibid 112.
[526] ibid.
[527] ibid.
[528] ibid. However, Penner adds that it is possible that a person becomes attached to the object, although this will be of secondary importance in a legal context.
[529] ibid 114.
[530] ibid.
[531] ibid 115.

In relation to claims, Penner suggests that historically they became assignable in English law only after imprisonment for debt was abolished. [532]Although not explicitly stated by Penner, this development suggests that assignability converted debt from being obligations which were personality-connected,[533] to independent things contingently belonging to the creditor. Penner thus argues that claims fulfil the contingency requirements because 'they are just barely things which permit the substitution of right-holder for another while maintaining the same character'.[534]

The above suggests that there is a close connection between transferability and Penner's contingency principle.[535] As Gold points out in his analysis of Penner, 'the first part of the separability thesis captures the idea that transferability is a key element of property'.[536] Thus, claims are contingent to the owners only because they are reified as objects distinct from a person and are thus transferrable.

The above suggests that Penner's contingency theory is not different from the views of other scholars, such as Harris and Rahmatian below, both of whom identify transferability as an indicator of a property institution. Importantly, in stating such views, there is a presupposition that transfer is an absolute criterion for a property object. As such, Penner, like Harris and Rahmatian, as seen below, suggest that because claims are assignable and contingent, they are property objects. However, as seen later, this view is controversial, as some authors, such as Gretton and Pretto-Sakmann, argue that transfer cannot be a good indicator for what amounts to a property institution. They may argue that although Penner is right that a person is entitled to his right because it is contingent, that entitlement relationship is not synonymous with ownership, but is simply what it purports to be: one of entitlement. [537]

It is also important to note that Penner seems to pay attention to the active (creditor's) side of obligation, rather than the passive (debtor's) side. From the debtor's, it is questionable if obligations are indeed contingent. As Penner admits: '[f]rom the debtor's perspective, the

[532] ibid; see also William Holdsworth, 'The History of the Treatment of Choses in Action by the Common Law' (1920) 33 Harvard LR 997, 1019–1020.
[533] Holdsworth (n 532) 1016. Holdsworth similarly notes that such rights were unassignable because they were personal to the parties bound by the obligation.
[534] Penner, *The Idea of Property* (n 367) 115.
[535] Benjamin also makes this connection in relation to Penner: Benjamin (n 258) para 13.28 footnote 34; however, see Penner, 'Bundle of Right' (n 367) 756 where he argues to the contrary that the right to make transfers is not entailed by property right.
[536] Andrew Gold, 'A Property Theory of Contract' (2009) 103 Northwestern University Law Review 1, 48.
[537] Penner, *The Idea of Property* (n 367) 112. Penner argues that another way of capturing the contingency test is through the statement: 'we are "entitled" to our right generally".

assignment of a debt can appear fundamentally to alter the whole debtor-creditor relationship [….]'[538] Thus, while from the creditor's angle, the claim is contingent, from the debtor's angle the right is always personal, since the debtor remains personally bound to satisfy the obligation. The reason for highlighting this point is because, as argued by Pretto-Sakmann below, the characteristic of property right is not to be found at the right-holder's end, but rather at the negative or liability end.[539] In her view, this suggest that although a claim is contingent on the part of the creditor, it remains a right *in personam,* since the debtor is always under a personal obligation.

Like Penner, Honoré likewise endorses the idea of ownership of claims, though tentatively. According to him, in law it is natural to speak of ownership of material objects than incorporeals. However, for incorporeals, such as claims, intellectual property rights and goodwill, Honoré contends that the incidents of ownership apply by analogy. Depending on the type of incorporeal, the incident of ownership may apply in a stronger or weaker sense.[540] For example, regarding intangibles such as copyright, leasehold property and goodwill, he argues that the analogy with the ownership of material things is a close one, although it applies in a somewhat weaker sense than when it applies to material objects.[541] Regarding debts (i.e. claims) and choses in action in English law, he argues that the notion of ownership 'is to be understood in a still weaker sense than that of copyright'.[542] Honoré contends that on the one hand, incidents such as alienability and transmissibility do apply to choses in action. However, there is no right to exclude others,[543] neither is there a prohibition from harmful use, arising in relation to material things.[544]

Honoré further argues that the 'thing owned should always be spoken of as a right'.[545] However, he admits that this is an 'odd-looking proposal, since "owning" involves "having certain rights to" a thing'.[546] According to Honoré, if therefore we substitute 'owning a pen' with 'owning certain rights in a pen', this suggests, erroneously, that the owner has 'certain

[538] ibid 115.
[539] Pretto-Sakmann (n 502) 206.
[540] Honoré (n 18) 116.
[541] ibid 113. His argument is that all the incidents of ownership applies except the incident of prohibition of harmful use. He also suggests that copyright is closely related to material objects because it relates to a material object which has certain characteristics, that is, that they are copies of the work in question; Pretto-Sakmann makes a similar point: Pretto-Sakmann (n 502) 105.
[542] Honoré (n 18) 132.
[543] As discussed below, some authors such as Rahmatian and Benjamin may disagree with this.
[544] Honoré (n 18) 131–132.
[545] ibid 133–134.
[546] ibid.

rights in certain rights in a pen […],' [547] and this may lead to an infinite regress. On this basis, Honoré suggests that speaking of owning rights rather than things is therefore 'doubly misleading'.[548] Both corporeal and incorporeal objects are things, and things are the object of ownership.

As discussed below, Rahmatian may agree with Honoré that things should be spoken of as right, or as legal abstraction or concept. But Rahmatian may add that Honoré's concern that it is misleading to speak of owning rights is unnecessary. This is because, as argued by Rahmatian below, property and property rights are synonymous. Therefore, it is unnecessary to speak about owning rights in rights and owning ownership, and so on, as if there can be a property right without a property object. However, as will be discussed later, Gretton may disagree with Rahmatian. Gretton may argue that although the idea of ownership presupposes a thing owned, that thing is a physical thing, not a right. Gretton may thus agree with Honoré that the idea of owning a right raises the risk of perpetual regression. However, unlike Honoré, Gretton may argue that the risk of regression is still there regardless of whether the 'right 'is reified as a 'thing'.

However, Honoré, Rahmatian and Penner all agree that claims can be the object of ownership. Like Honoré, Rahmatian and Penner may agree that the application of these rights and powers may depend on the type of *res*. For example, both Rahmatian and Penner agree that the concept of possession does not apply to claims.[549] Honoré may not disagree, but may add that the fact that the right of possession does not apply implies that such principles apply by analogy, even in a weaker sense.

Although these scholars are similar on these points, Honoré takes a 'bottom-up' approach, using the powers and rights vested in an owner to identify a property object, while Penner and Rahmatian, as noted in section 5.4.1 adopt a top-down approach which treats a real right as a unified concept, with the powers and rights as attributes. However, Honoré and Harris offer an account which appeals to the functional method, as suggested by Sjef van Erp below,[550] as they argue from the standpoint of the specific concrete rights a person/owner has in relation to an object.

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[547] ibid 134.
[548] Honoré (n 307) 134.
[549] Rahmatian, *Copyright and Creativity* (n 309) 8; Penner, 'Bundle of Right' (n 367) 756.
[550] Sjef van Erp, *European and National Property Law: Osmosis or Growing Antagonism* (Walter van Gerven Lectures (6), Europa Law Publishing 2006) 18. He notes his method is functional. Thus, he identifies property objects based on the contents of the rights.

Harris similarly affirms that claims can be the object of ownership. In his view, the object of property need not be corporeal. An item 'comes within the scope of a property institution […] if either it is subject to specific trespassory protection or if it is separately transmissible as part of a person's wealth'.[551] In Harris's view, transmissibility is a broad term referring to the owner's power to transfer property as an agent of wealth-allocation in exchange for other scarce resources.[552] Trespass rules, on the other hand, refer to rules which impose obligations (negative or positive) upon an open-ended range of persons. They may include the right to sue for damages or other remedies protecting the property.[553]

Harris describes choses in action as one type of 'cashable rights', that is, something over which an owner has 'ownership privileges and power, especially money'.[554] In his view, claims as 'reified entities may be subject of direct trespassory protection', as where for example, bank balances are stolen and restitutionary remedies protect their monetary value.[555] In terms of their transmissibility, Harris notes that where rights are assignable, the holder has all the ownership powers which the money equivalent of his right will afford.[556] According to him, it is their 'cashability' which brings claims within the scope of property institution. [557]

What ties these scholars together (i.e. Harris, Penner, Honoré) is that they define objects of ownership based on the fact that property law principles apply to claims. Because these principles apply, there is the assumption that claims can be objects of are ownership. For example, Harris admits, as seen above, that the rules which apply to intangibles, including the rules on transmissibility and trespassory protection, are rules which the law had earlier modelled for tangible assets. Similarly, Honoré also writes about the incidents of ownership which apply to tangible things applying by analogy to intangible things. However, although Penner is not explicit on this point, his separability thesis presupposes that transfer is a prerequisite for a property institution.

The approach adopted by these scholars is circular. If property law rules, such as the rules on transfer, apply to intangibles, the obvious conclusion is that they are indeed objects of ownership. It is thus impossible to escape from that conclusion if the rules used to identify them as objects are themselves property law rules. On the contrary, it may be argued that the proper approach ought to be to ask, first, if those rules are indeed exclusive indicators of a

[551] Harris (n 501) 42.
[552] ibid 27.
[553] ibid 25.
[554] ibid 50.
[555] ibid 50–51.
[556] ibid 51.
[557] ibid.

property institution. For example, Gretton and Pretto-Sakmann, as seen below, argue that the fact that an object can be transferred is not conclusive that it is an object of ownership. Both authors may argue, as seen below, that real rights and personal rights can be transferred and vindicated in some cases, but these characteristics do not indicate that they are property objects. We will consider their views, which are based on the German Pandectist's ideas. Before we proceed, it is important to briefly provide some background to Gretton and the Pandectist's analysis. Their analyses are a reaction to the Gaian Scheme, which although historical, is one of the precursors to the modern idea of property objects.

6.3 GAIAN SCHEME: THINGS AS THINGS AND RIGHTS AS THINGS

It is said that the doctrinal approach widely used in classifying property objects is the Gaian Scheme.[558] The scheme divides things into tangibles and intangibles.[559] However, the distinction between physical things and intangible things did not start with Gaius. For example, Cicero differentiated between *quae sunt,* 'things which exist' in the physical sense and *quae intelleguntur,* 'things which are imagined by the intellect.[560] Gaius similarly proposed a general class of things along these lines. Corporeal things are items with a physical nature like land and a car. Incorporeals are intangibles. Gaius refers to incorporeals as servitudes, inheritance, a usufruct, obligations. As noted, these are mainly legal creations or things which exist by 'legal fiction'.[561] However, as will be seen below, Gretton and Rahmatian do not make the distinction between corporeal and incorporeal. They both suggest that the content of the Scheme (i.e. things)[562] ought to be legal rights or legal concepts, although Gretton retains the corporeality in another form while Rahmatian completely detaches the physicality from the *'thing'* even in the case of tangible things.

Because Gaius refers to both corporeal and incorporeals as *things,* there is a question whether *things* refer to just physical things alone? Apparently, the answer is that things cannot be physical things because incorporeals are rights. Rights are therefore *things,* even though they have no physical presence. In Civil law systems, these rights are referred to as patrimonial rights.[563] Giglio notes that for the Pandectists, this was a classification of patrimonial rights. [564]

[558] Tarrant (n 307) 678.
[559] Gaius, *Institutes* (W. Gordon and O. Robinson trans., 1988) 127 [Book 2.12].
[560] Cicero *Topica* Loeb Classical Library Vol 386 (Harvard University Press 1949 reprinted 2000) (Hubbell HM translation) cited in: Pretto-Sakmann (n 502) 88.
[561] MacCormick (n 63) 136.
[562] Gretton replaced 'things' with patrimony.
[563] Gretton, 'Ownership and Its Objects' (n 307) 813; Giglio (n 504) 7.
[564] Giglio (n 504) 9.

However, it was difficult to explain how tangible objects which do not have any legal value can be part of the patrimonial rights.[565] The physical world and the legal world belong to two different spheres. The physical world was the world of facts, while the items in the legal world were items recognised by the human intellect.

6.4 OWNERSHIP AS A RIGHT TO A CORPOREAL THING

The Pandectists, Gretton and Pretto-Sakmann therefore set out to dispel the idea that both corporeals and incorporeals can be the objects of a real right. However, it is important to note that these issues are not restricted to the Civil law alone. There are doctrinal writers in both the Civil law and Common law who reject the Scheme and restrict ownership to corporeal things. In Civil law, as already mentioned, there is the Pandectists whose views are behind the provisions in the German Civil Code, which restricts ownership (*Eigentum*) to a tangible thing (*Sache*).[566] Gretton, also writing within the Civil law tradition, follows the Pandectists. In the Common law, although it is less controversial that claims can be the object of ownership ,[567] there are scholars who restrict property rights to tangible things. For example, McFarlane defines a property right as a right to objects 'that can be physically located'.[568] Although he does not offer any detailed argument in support of this view, he refers instead to Pretto-Sakmann. This suggests he accepts her argument as the basis for his position. As discussed below, Pretto-Sakmann's position is substantially similar to that of the Pandectists and Gretton.[569]

As mentioned previously, the Gainan Scheme divides things into corporeals and incorporeals. The former refers to tangible assets, while the latter refers to intangible asset, such as claims. The latter are essentially patrimonial rights. However, the right of ownership is not included in the Scheme. It is argued that the reason why ownership is not mentioned is because the Romans had not developed the idea of ownership as a right. Gretton contends that the Roman sources did not 'describe ownership as a "*ius*": to have a thing and to have

[565] Gretton, 'Ownership and Its Objects' (n 307) 847.
[566] See § 90 and 903 of the *Burgerliches Gesetzbuch*.
[567] The dominant position is that they can be the object of ownership: *Dearle v Hall* (1828) 3 Russ 1, where the court held that there can be a property right in a chose in action and that the rules applying to personal property likewise apply to them. Similarly, modern textbooks take it as an obvious fact that choses in action are objects of property. Thus, any question regarding their property-like characteristics rarely arise; see McKendrick (n 305) 31–32; FH Lawson and Bernard Rudden, *The Law of Property* (OUP 2002) 29; Fidelis Oditah, *Legal Aspects of Receivables Financing* (Sweet & Maxwell Ltd 2011) 32.
[568] McFarlane (n 431) 4.
[569] Pretto-Sakmann (n 502) 100.

ownership of a thing were the same'.[570] This conclusion, however, is said to be contentious. It is argued that Gaius mentioned *dominium* occasionally in his *Institutes*.[571] It was therefore improbable that the Romans left out ownership because it was not conceived as a right.

In the Pandectist's interpretation the Gaian Scheme is about a classification of patrimonial rights. In Civil law a patrimony contains the entirety of rights and duties conferred on a person. Tangible things exist in the physical world until the law brings them into its system of ideas 'by attaching legal interest to them. Through this passage, physical things lose their corporeality to become legal things. Legal things are not physical things; they are concepts'.[572] Therefore, when Gaius mentions tangible things alongside rights, such as obligations, this raises questions about the structural unity of the Scheme: how physical things can be included in a patrimony alongside patrimonial rights?

The Pandectist therefore sought to find an explanation for this. They started, as noted, from the premise that the Scheme contains patrimonial rights. They maintained that when Gaius mentions gold, silver, land as corporeal things, he in fact refers to ownership. But this is merged with the physical thing.[573] Therefore, the physical thing merges with the right of ownership. Windscheid argued that the Scheme differentiated patrimonial rights that had material existence and those which existed in the imagination.[574] The Pandectist thought that the Romans were not able to escape from the idea of direct connection between a person and a tangible thing.[575] To have the tangible thing is to have ownership of the thing, and hence it will have been 'useless pedantry to refer to ownership when only corporeal things could be vindicated'.[576] Consequently, corporeal things referred to things which are the objects of the right of ownership, while incorporeal things refers to patrimonial rights or incorporeal legal interests.[577]

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[570] Gretton, 'Ownership and Its Objects' (n 307) 806 referring to; Birks (n 397) 1.
[571] Giglio (n 504) 11. See Gaius, *Institutes* [Book 2.20 and 2.40]
[572] ibid 10. This view is similar to Rahmatian's as discussed below.
[573] ibid 8.See historical sources in footnote 25 of Giglio's article.
[574] Bernhard Windscheid, *Lehrbuch Des Pandektenrechts* (5th edn, 1882) 17:([Man] denkt sich auch die übrigen Vermögensrechte ... als Sachen, und nennt sie, da sie nur in der Vorstellung, nicht in körperlicher Wirklichkeit existiren, gegenüber den körperlichen Sachen un- körperliche Sachen.) : '[O]ne regards even the other [i.e., non-ownership] patrimonial rights [...] as things and calls them incorporeal things, as opposed to corporeal things because they exist only in the imagination, not in the corporeal reality.'; the citation and translation are from: Giglio (n 504) 8 footnote 26.
[575] Samuel (n 307) 529; Giglio (n 504) 529.
[576] Giglio (n 504) 9.
[577] ibid.

In arriving at the above conclusion, the Pandectist sought to differentiate the different instances of 'subjective rights' and their objects. Windscheid formulated subjective right 'as a discretionary power given by the legal order, by which the command of the legal order is converted into commands of private legal subjects'.[578] Subjective rights may either be absolute or relative. In English law, these correlate with rights *in rem* and rights *in personam*. Absolute rights are rights exigible against everyone, while relative rights are rights exigible against specific persons. However, absolute rights are not synonymous with real rights [579]since there are rights which are absolute but are not real rights: for example, rights protecting bodily integrity.[580]

Windscheid argues that rights manifest themselves in the form of relationships. However, if the core characteristic of all subjective right is a relationship, the relationship is inadequate to explain the distinction between absolute and relative rights, as both are relational. Windscheid therefore argued that in addition to the relationship, the object of the right is also important. In the case of absolute rights, the object will be a corporeal object; for relative rights, there is no object representing the underlying relationship.[581] They are rights against persons.

Pretto-Sakmann re-echoes Windscheid's view. She argues that real rights follow a corporeal thing. 'Where the corporeal thing is located, there the right can be demanded.'[582] However, the 'burden of a right *in personam* attaches to a person[…] There is nothing to find, nothing for the burden to follow, apart from the person'.[583] Thus, for real rights, the owner can demand for the corporeal thing simply because he has located the corporeal thing to which the

[578] '*Eine von der Rechtsordnung Verliehene Willensmacht, durch die sich der Befehl der Rechtsordnung in Befehle der Einzelnen Rechtssubjekte Verwandel*t.' Cf Bernhard Windscheid, I Pandektenrecht (1891) § 37 n 3: citation and paraphrase obtained from: Mincke (n 304) 81,see footnote 11.
[579] To be distinguished from *ius ad rem*¸ a right to the acquisition of a thing. Rahmatian, *Copyright and Creativity* (n 309) 5; Pretto-Sakmann (n 502) 105.
[580] It is debateable if intellectual property rights are real rights. Gretton suggests that they are absolute rights, not real rights. However, Rahmatian shares a contrary view, that they are real rights: Gretton, 'Ownership and Its Objects' (n 307) 830,841; Rahmatian, 'IP and Dematerialised Property' (n 20) 371–372.
[581] Mincke (n 304) 81.
[582] Pretto-Sakmann (n 502) 105.
[583] ibid.

burden of the right attaches. However, for rights *in personam*, the burden follows the person against whom it arose; there is no corporeal thing to follow.[584]

Windscheid and Pretto-Sakmann seek to preserve the distinction between rights *in rem* and rights *in personam*. As discussed below, Rahmatian also shares this concern, as, seen below, he defines a right *in rem* as a right which relates to a thing.

These views are in contrast to Hohfeld who notably defines both a right *in rem* and right *in personam* in relation to persons, rather than things. Hohfeld defines a right *in rem* as a right residing in a 'single person (or group of persons) but availing respectively against persons constituting a very large and indefinite class of people'.[585] He contrasts this from a right *in personam* which he defines as a right residing 'in a person (or group of persons) availing against a single person (or single group of persons)[….]'[586]

Thus, unlike Hohfeld who defines a right *in rem* in relation to persons, Windscheid, Pretto-Sakmann, Rahmatian and Reid below all define a right *in rem* in relation to a thing. However, while Windscheid and Pretto-Sakmann define the thing strictly as a corporeal thing, Rahmatian, as will be seen below, argue that things, whether tangible or intangible, are all strictly incorporeal in law. Because of this, the object of ownership in law is, in all cases, an incorporeal thing.

Gretton refines the Pandectist approach.[587] According to Gretton, a 'failure properly to develop the concept of patrimony lies at the root of much confusion' concerning the Gainan Scheme and objects of ownership.[588] For this reason, Gretton emphasizes the concept of patrimony. Like the Pandectists he argues that the contents of a patrimony are rights, not things (corporeal or incorporeal). Following from this, Gretton argues that ownership is therefore not to be defined as a relationship between a person and a right. It is not synonymous with titularity which designates such a relationship, that is, the relationship between a person and elements

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[584] ibid 106.
[585] WN Hohfeld, 'Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1917) 26 Yale LJ 710, 718. Penner's criticism of Hohfeld was discussed in section 5.4.1. As is known, Hohfeld, in recognising the ambiguity in how 'right' and 'duties' are used in law, breaks them down into several correlatives and opposite. The legal interests and their correlatives are: rights/duties; privilege/no-right; power/liability; immunity/disability. While their opposites are: Right/No right, privilege/duty, power/immunity, immunity/power. In relation to rights in rem, an owner's right correlates with duties on a large class of people not to interfere. Penner, *The Idea of Property* (n 367) 23.
[586] Hohfeld (n 585) 718.
[587] Gretton, 'Ownership and Its Objects' (n 307) 804.
[588] George Gretton, 'Owning Rights and Things' (1997) 8 Stellenbosch LR 176, 177.

of his patrimony. This relationship, according to Gretton, is best characterised as one of 'having', not owning. According to Gretton, 'have' is a fundamental legal concept which refers to the relationship of a person to a right.[589] Titularity, or entitlement, therefore links a person and the various elements of his patrimony and rights , i.e. real rights, intellectual property rights, and personal rights.

Since rights, and not things, are the elements of the patrimony, rights are the objects of acquisition and transfer. A patrimony contains rights which may be transferred, but the patrimony cannot be transferred. This idea, unlike the Gaian Scheme, raises no confusion as to whether everything within the patrimony can be the object of ownership. It delineates the different patrimonial rights, which includes ownership and other limited rights which derive from it.

Furthermore, Gretton, like Windscheid, defines ownership as a type of absolute right.[590] Ownership is also a real right and is one type of primary right. In Gretton's opinion, a primary right is any right which is not a limited right. One of the features of a primary right is that it is residuary, that is, the right remains even after other rights are carved out. Gretton accepts that this definition is not different from the normal understanding of ownership as a residuary right. Also, all primary rights are residuary, including primary rights in personal rights.

According to Gretton, real rights are rights which have physical things as their objects. Ownership is a real right [591] as well as the 'primary real right' and therefore has a physical thing as its object.[592] However, because the patrimony contains rights and not things, the right of ownership does merge with the physical thing.

Gretton, the Pandectists and Pretto-Sakmann therefore all argue that personal rights cannot be the object of ownership. However, Gretton argues that a 'primary' right may be held in a personal right in the same way that ownership is primary.[593] As seen above, a primary

[589] ibid.
[590] The other absolute right, according to Gretton, is intellectual property law. Gretton accepts the traditional definition of absolute rights as rights which have *erga omnes* effect. They may be conditioned by a 'thing' or an ideational entity (for intellectual property).
[591] The other real right is a subordinate real rights. There can also be subordinate rights in intellectual property right and personal rights.
[592] Other primary rights are primary rights in intellectual property and primary rights in personal rights.
[593] Gretton, 'Ownership and Its Objects' (n 307) 834.

right, according to Gretton, is a right which is not limited, it is a right which is not determinable or contingent. Gretton contends that in the case of a debt, where A lends B money, A's right in the debt is primary and its object is, according to Gretton, the prestation or performance of the obligation.

Gretton admits that the unitary law of transfer applies to both the transfer of primary real rights and primary personal rights. [594] However, he argues that because it is a unitary topic which covers both real and personal rights, there is a temptation – which we saw with Penner, Honoré, Harris and even Rahmatian below – to define property objects based on their transferability. However, Gretton argues that this position is wrong for the reasons below.

Before considering Gretton's response, it is important to note that there are two senses in which transferability is used as a criterion to supposedly identify a property institution. The first, as noted by Honoré , is that a person vested with ownership 'normally has both the power of disposition and the power of transferring title'.[595] In the Civil law context, this is the right to destroy or alienate the thing (*abusus*). Therefore, because the holder of a personal right (claim) can transfer his right under a contract, this implies that he has a property right over the claim. Harris' captures this clearly that 'contracts presuppose the institution of property. The contractor on one side at least offers to transmit something over which he has ownership privileges and powers [….]'[596] In essence, this supposedly implies that transfer arises because an owner will normally have the power, vested by a *real* right, to deal with the assets or claims.

The second sense in which transferability is used to denote a property right is in relation to the effect of transfer on third parties. In most systems, transfers are analysed in two stages. The first stage is the contractual stage which confers personal rights on the transferee. The second stage is the actual transfer. [597] While in the first stage, the transferee is at the risk of having his claim defeated in the event of the transferor's insolvency, in the second stage, the risk seems to be replaced by a real right which is immune to the insolvency of the transferor. In effect this supposedly allows the transferee to claim against the debtor from whom performance is expected, thereby bypassing the transferor's insolvency estate.

Although Gretton responds only to the second sense above rather than the first, it is possible to make out his response to the first, that is, that transfer denotes that the owner can deal with the

[594] ibid 848.
[595] Honoré (n 18) 118.
[596] Harris (n 501) 50.
[597] Most systems require notice to be given to the debtor at this stage. See sec 136 (1) Law of Property Act 1925 (English law); §409 German Civil Code; Article 3:94 (1) Dutch Civil Code.

assets. Gretton may argue, as already noted, that transfer is a unitary concept applying to both absolute rights and personal rights. Therefore, it will be wrong to superimpose the idea of a property right on a claim every time a transfer of claim occurs. This implies that the concept of transfer is not restricted to property rights alone; it applies to personal rights, since they form part of the patrimony and a person can transfer the objects of his patrimony (real, intellectual property right and personal rights). Secondly, Gretton may argue that because a person can have a primary right in a personal right, this implies that the holder of the right likewise has the power to transfer the right or carve out limited rights from such rights.[598] Thirdly, Gretton may also argue that if transfer is an indicator of a property institution, this will mean that all personal rights are real rights.[599] Therefore, the holder of a personal right will have both the right of ownership and the right of ownership of the personal right. In the case of the transfer of such a personal right, this brings about an odd situation, that is, the objects transferred are the right of ownership and the right of ownership of the personal right. The oddness of this situation becomes more pronounced in the transfer of a limited right. Thus, where a limited right is transferred, it implies that the objects transferred are the right of ownership and the right of ownership of the limited right. This is odd because the holder of a limited right has only a limited right, while ownership is vested in another party. Therefore, he can transfer only the limited real right. In summary, Gretton may argue that , unlike Penner, Honoré and Harris, and Rahmatian seen below, transferability may not be a pointer to a property institution, as that has the potential to close the boundary between real and personal rights.

In relation to the insolvency effect of transfers, Gretton argues that the relative right which a transferee has against a transferor does not convert to a real right once the transferor becomes insolvent. Instead, the relative right against the transferor disappears, and in its place the transferee has another relative right against the debtor. It remains a personal right that may be vindicated against the debtor.

Pretto-Sakmann makes a similar point in a different context. It is said that claims are objects of property because they are protected through the tort of knowingly procuring a breach.[600] However, Pretto-Sakmann argues that this is wrong. Although the remedy arising from inducing a breach shows that claims can be vindicated, in substance what is protected is

[598] This view can be made out because Gretton argues that it is possible to create limited rights in personal rights. Because a person can create a limited real right, this suggests he has the power to deal with the right, as well as the power to transfer it. Gretton, 'Ownership and Its Objects' (n 307) 838–839.
[599] ibid 836.
[600] The leading case on this point is *Lumley v Gye* (1853) 2 EI BI 216; Rahmatian, 'Debt' (n 497) 212.

a personal right. She points out: 'If I say I own my right to claim money from you, the fact of my entitlement to that right in no way alters the fact that what I have is a mere right *in personam*'.[601] She adds that 'even if I can defend that relationship with you against interference from third parties, what I am defending is still a mere right *in personam'*.[602] She argues that the Hohfeldian definition above lies behind the temptation of characterising claims as objects of property simply because the remedy of inducing a breach is directed at third parties.[603] In other words, because the remedy implies that a party can assert a right against a third party, this makes claims a property object. However, as mentioned above, she argues that this cannot be accurate: what is defended is still a personal right.

Although Gretton and Pretto-Sakmann accept that a claim can have a third-party effect, they reject that such an effect is premised on a real right. The similarity in their view is not surprising, since, as already noted, they both define a real right in terms of a right in a corporeal thing. The effect of this is that, as Gretton argues, rights which derive from a real right have a physical thing as their object, while rights which derive from a personal right are directed towards the debtor.[604] Pretto-Sakmann expresses something similar :'the liability to recognise my [real] right and honour it attaches to anyone [into] whose hands the [physical object] comes'.[605] But for personal rights, 'the burden attaches to a person [….] There is nothing to find, nothing for the burden to follow, apart from that person'.[606] Therefore, although claims can be vindicated against third parties who induce breach, this consists in them being vested in a person, unlike real rights where the burden follows the thing.[607]

Two observations may be made in relation to the foregoing discussion. The first, as will be argued further below, is the pre-emptive nature of the views of the Pandectists, Gretton and Pretto-Sakmann. Because their views restrict real rights to a corporeal thing, it is impossible to define property institutions without reference to corporeality. Secondly, their views raise the question as to whether ownership and titularity are the same concepts since they have the same effect.

[601] Pretto-Sakmann (n 502) 206–207.
[602] ibid.
[603] ibid.
[604] Gretton, 'Ownership and Its Objects' (n 307) 838.
[605] Pretto-Sakmann (n 502) 105–106, 206.
[606] ibid 105.
[607] ibid 206.

6.4.1 Corporeality as the dividing line between property and obligation

As mentioned, the views of the Pandectists, Gretton and Pretto-Sakmann are quite pre-emptive. Because Windscheid, as well as Gretton and Pretto-Sakmann, define rights *in rem* as rights in corporeal things and relative rights as rights against specific persons, this, from the outset, suggests answers to, for example, the issues regarding the concept of transferability discussed above. For example, if claims give rise to personal rights for any reason, they can only be personal rights for all reasons, since rights *in rem*, from the outset, are defined as rights in a corporeal thing. Primarily, the category between real rights (corporeal things) and personal rights is clearly demarcated from the outset, meaning that claims cannot, by any chance, fall within the category of real rights, even if they become reified objects. Therefore, the definition of real rights as rights in a corporeal thing renders it meaningless to even delve into such issues as to whether claims can be the object of real rights in the first place, since any answer to that question necessarily follows from the broader distinction between real and personal rights.

Similarly, it follows that the tort of inducing breach *simpliciter* cannot help with identifying a property institution, since property is defined, from the outset, as a right in a corporeal thing. For such third-party effects to be a useful requirement, it must be premised on a real right which has as its object a corporeal thing. We also see this circular approach in the argument of Pretto-Sakmann above, where she argues that the remedy of inducing a breach cannot be a good indicator of whether claims are valid object of ownership. According to her, the reason why that is the case is because the remedy of inducement protects a personal right, not a corporeal thing. Because she defines a real right as a right in a corporeal thing, this presupposes an answer to that issue.

This does not render these scholars' argument worthless. First, there is a consensus that the well-established distinction between property (real rights) and obligation (personal rights) needs to be maintained. We find support for this view in Gretton and Pretto-Sakmann, and Rahmatian and Reid whose arguments will be discussed below. Since this is an established fact, the question is whether having real rights in personal rights maintains this well-established distinction? As will be seen below, Rahmatian and Reid argue that it does if personal rights are treated as *res* through the process of reification of the personal rights as obligations (i.e. claims) to which the real rights attach. However, as seen above, the Pandectist, as well as Gretton and Pretto-Sakmann, essentially argue that that this distinction collapses if real rights can be held in claims (personal right). According to them, it does not matter whether personal rights are reified as obligations (*res*); the underlying right remains a personal right.

The point may be made that if it is accepted that there ought to be a distinction between property (real rights) and obligation (personal rights), then the circularity in the arguments of Pretto-Sakmann, for example, is necessarily premised on that distinction. Thus, the analysis of these authors, compared to the analysis of Rahmatian and Benjamin below, offers a better account which retains the distinction between real rights and personal rights. In contrast to Pandectists, Gretton and Pretto-Sakmann, it is argued by Rahmatian, Benjamin and Reid that claims give rise to both personal and property rights. They are personal rights as between the parties involved, but are property rights because, as already noted, they have third-party effects as a result of the remedy of inducing breach which is directed at third parties.

The contrasting views of these scholars may be expressed in another way: that is, as reflecting the contrasting position regarding the definitions of rights *in rem* between the Pandectists on the one hand and Hohfeld on the other hand. As noted, Hohfeld defines a right *in rem* as a right in relation to the persons rather than things, and this, as rightly noted by Rahmatian, gives rise to the problem that real rights can 'be explained away as merely particular manifestations of personal rights[….]'[608] However, in arguing that claims give rise to both personal and real rights, Rahmatian's analysis potentially may come under this Hohfeldian definition with the effect that it attracts the same criticism which Rahmatian himself expresses towards Hohfeld.

In relation to the broader question on system-neutrality of ownership of claims, it is important to note that the primary aim of the argument is not to endorse the Pandectist's, Gretton's or Pretto-Sakmann's approaches in contrast to Rahmatian's or Benjamin's. Importantly, the aim is to demonstrate that the contrasting approaches have legitimate claims, and thus the idea of ownership of claims is system-dependent. This is demonstrated by showing that the debate about ownership of claims/personal rights centres around the need to maintain the distinction between property and obligations. On the one hand, we have the Pandectists, Gretton and Pretto-Sakmann whose approach maintain this distinction. On the other hand, we have doctrinal writers like Rahmatian, Benjamin and Reid, whose views are similar to the position in English law, which takes a flexible approach to the property and obligation distinction These contrasting approaches are understandable if we take into account that Gretton, the Pandectist and Pretto-Sakmann start off their analysis with a major focus to maintain that distinction. It is therefore not surprising if any conclusion reached by them persistently affirms that objective. Therefore, since that is their aim from the onset, it is not surprising that their theory closely maintains that boundary. This may be contrasted with Rahmatian and Benjamin as seen below, to whom this issue, although of

[608] Rahmatian, 'IP and Dematerialised Property' (n 20) 365.

importance, is secondary, to be accommodated only after a system of property objects have been set out.[609]

6.4.2 Ownership and titularity as functionally the same?

Another observation may be made in respect of Gretton's and Pretto-Sakmann's idea of titularity or entitlement.

First, it may be said that the idea of titularity is only necessary if we reject the claim that rights cannot be the objects of ownership. Since in Gretton's views, rights are not valid objects of ownership, it becomes necessary to characterise the alternative relationship between a person and personal rights. Therefore, the premises of his argument make it necessary to differentiate ownership and titularity.

It may also be argued that even if there is a difference between ownership and titularity, Gretton fails to develop the concept of 'have' further. In fact, there are suggestions that the two concepts are the same. For instance, as seen above, Gretton argues that a primary right can be had in both real rights and personal rights. He also defines a primary right as a right which is not a limited right. They are residual and can be held in the same way that ownership is primary. This suggests that Gretton's primary right in personal rights is not different from the right of ownership as it is conceived in most systems. Thus, in the same way that an owner's right in a physical thing is primary, so also the holder of a personal right can have a primary right in a personal right, which is not limited, and which has a residuary effect. This suggests that there may not be a clear-cut distinction between both concepts. Sjef van Erp , and also the Directive, alludes to this point that the contents of both ideas are the same.[610] Indeed, as Gretton and Pretto-Sakmann admit, these rights may include the right to transfer the asset, or protection from insolvency, as well as the right to vindicate it through the tort of inducing by false pretence or creating a limited right.

However, the observation above misses some points. First, if Gretton's argument presupposes the need for an alternative concept (i.e. titularity), this in fact is the aim of his argument, that is, to identify another concept to express the nature of the relationship between a person and rights in his patrimony. Additionally, the premise of his argument does not just indirectly presuppose the conclusion, as normally will be the case in *petitio principii* cases; it contains substantive analysis as seen above which leads to the conclusion that ownership is not

[609] Rahmatian does not mention frequently the importance of maintaining this distinction: see Rahmatian, 'Debt' (n 497) 211 where this is mentioned in few lines.
[610] Erp, *Osmosis or Antagonism* (n 550) 18.

a concept which applies to rights. Therefore, in rebutting that claims can be the objects of ownership, he renders a justification for his alternative concept, rather than just indirectly presupposing it.

Secondly, the similarity between titularity and ownership, as suggested by Gretton, may be one of the reasons why the concepts are conflated. Although personal rights can be transferred and vindicated against third parties, this does not mean that they are real rights. The two concepts may be the same in terms of particular effects, but those effects, as will further be discussed below, are results of different doctrinal rules. However, because the effects are the same, does this suggest that a system-neutral idea, as presupposed by the functional method, can be identified in terms of those particular effects? Before discussing this question, we will examine, in more detail, the views of Rahmatian, Benjamin and Reid.

6.5 PROPERTY/PROPERTY RIGHTS AS LEGAL CONCEPTIONS

Rahmatian writes in support of the notion of ownership of claims. He provides a comparative perspective encompassing both the Common law and Civil law. Another author who has written in support of ownership of claims, and financial collateral in particular, from the Common law perspective is Benjamin. Her core argument is similar to Rahmatian's, as will be seen below. She argues that both real and personal rights arise in relation to claims: '[A]s against the debtor, the creditor can only assert personal rights in relation to the debt'.[611] However, they can be the subject of property rights as against someone other than the obligor.[612] According to Benjamin, real and personal rights are not inherent in the asset; they are dependent on whom one is suing. 'In other words, property is the function of particular actions, not of particular assets.'[613]

Benjamin's view reflects the general approach under the Common law which as discussed in section 5.3 describes objects of right (i.e. real and personal property) in terms of the type of action which historically can be brought in respect of the objects. As already indicated, the concrete effects of Rahmatian's approach in particular relations to claims is also similar to her views. Their views will be assessed together.

[611] Benjamin (n 258) para 13.10.
[612] ibid 13.51.
[613] ibid.

According to Rahmatian, 'property'[614] and 'property right'[615] can be used interchangeably.[616] Although this idea is not new, Rahmatian's is based on a more elaborated idea.[617] Rahmatian defines a real right as 'an abstract concept created by law which relates to an object or res (*thing*)'.[618] He adds that 'real rights are relations between persons with regard to things, thus they are represented by behavioural patterns, typically possession, which denote visibly the owner's right. In his view, 'it is this behavioural pattern, prescribed by law, which makes the real right'.[619]

According to him, 'since real rights are legal creations, they have no natural existence beyond the law and are subject to legal change as to their existence and extent'.[620] This presupposes that property rights are not natural rights in the Lockean sense. They are rights created by positive law.

According to Rahmatian, the object of a real right can be a physical thing or a notional, abstract entity.[621] In his view, there is no difference between the two conceptually: 'The law – in this context: private law—creates any *res* or things, whether corporeal or not, through the legal concept of real rights that enables legal recognition of the *res* in question'.[622] Rahmatian argues that a physical thing does not exist in the legal sphere; it only becomes a thing or *res* when a real right is attached to it and the law incorporates it into the 'abstract-normative system' of things.[623] Therefore, if the law does not identify an object as an object and attach a real right to it, the object does not exist in law.

Rahmatian argues that although the physicality of the *res* is unimportant, there is the possibility of the social reification of the object. However, the tangible thing is merely a 'convenient "social crutch" for the actors in the physical world and not conceptually necessary for the law and the existence of the concept of the *res'*.[624] Thus reification may depend on the

[614] This is used in a more specific sense by Rahmatian to refer to the objects of real rights and should not be confused with the normal usage to denote ownership.
[615] This refers to the real right.
[616] Rahmatian, *Copyright and Creativity* (n 309) 11.
[617] Honoré (n 18) 128 who notes that the close connection between the objects of property and property rights means it is typical to refer to both as property.
[618] Rahmatian, *Copyright and Creativity* (n 309) 5.
[619] Rahmatian, 'Debt' (n 497) 209.
[620] Rahmatian, *Copyright and Creativity* (n 309) 7–8.
[621] ibid 5.
[622] ibid 10.
[623] ibid. This argument is similar to the Pandectist's analysis discussed earlier that physical things lose their corporeality to become legal things or concepts only when the law incorporates them into its system by attaching legal interests in them.
[624] ibid.

nature of the *res* or some other factors. For example, in the case of a physical object, the social reification is 'automatic':[625] the 'materiality of the object that is recognised normatively as *res* serves as reifer'. [626] Where the object is a claim, it may be reified in writing or by paper instrument, such as negotiable instrument. However, for a claim or pure intangibles, Rahmatian suggests that there is necessarily no physical social reifer that represents the *res*. According to Rahmatian, the effect of this is that in the change of allocation of entitlement, 'the central party to perform the obligation, the debtor, must acknowledge the assignment to effect the transfer of entitlement from the old to the new creditor vis-à-vis third parties'.[627]

The foregoing suggests that there is a close connection between the reification of the *res* and the nature of real rights as relational rights. Because real rights are relational and affect actors in the physical world, there is the need to reify the *res* as a visible sign of the underlying activity brought about by the conferral of the right. For example, there may be the need to denote visibly the possessor's entitlement to the asset to other parties, as seen in the case of possessory securities in most systems, or even in the requirement of notification for assignment of claims. In both cases, Rahmatian's theory suggests that the underlying reason why reification is needed is because of the relational nature of the real right. However, this contrasts with Windscheid who argues, as seen above, that subjective rights are generally relational. In his view, the relationship is inadequate to explain the distinction between absolute rights and relative rights, as both are relational. This is what leads him to define absolute rights in terms of corporeal objects to distinguish personal rights from absolute rights. Rahmatian's analysis, however, takes a different approach as it does not avoid a concept of (relational) real right which accommodates incorporeals. As seen below, the risk in Rahmatian's view, which Windscheid highlights, is that, like Hohfeld, it collapses the distinction between real and personal rights.

As earlier noted, Rahmatian argues that there is historical support for the abstract conceptualisation of object of property. He contends that the feudal root of the English land law contained the notion of 'tenure' which is the precursor to the idea of estate in land in modern times. According to Rahmatian, for tangible objects such as land, the law has been able to place an abstract concept between the right-holder and the object: 'one owns an estate in the land, since the land itself is (notionally) owned by the crown'.[628]

[625] ibid.
[626] ibid.
[627] Rahmatian, 'Debt' (n 497) 212.
[628] Rahmatian, *Copyright and Creativity* (n 309) 11.

He further argues that the notion of dematerialised, abstract property implies that there is no property without a property right. Therefore, it is 'strictly speaking not incorrect to use terms 'property' and 'property right' interchangeably: if there are no real rights, there is no *res* in law, if there is no *res* in law (regardless of possible objects in the material world), then there are no real rights'.[629] The law must attach a real right to an item for it to be identified as a valid object.

How does this theory apply to obligations (claims)? In relation to claims, Rahmatian argues that the 'obligations out of which claims and debts arise as *jura in personam* is itself res'.[630] According to Rahmatian, there are reasons to buttress this view. First, the English law chose in action correctly reflects this. Secondly, 'assignment of a contractual claim emphasises its property quality as a *res'*.[631] The above will suggest that the law endorses claims as *res* (thing), and since they are *res*, it is presumed that they are so because real rights attach to them.

Although the two reasons above given by Rahmatian are inadequate [632], it is not difficult to understand why he may have no problems identifying obligations as *res*. His theory supposes that because objects of real rights are legal abstractions (dematerialised property), and claims are properly so-called legal rights, it is therefore not problematic identifying claims as *res*. In fact, claims qualify as an ideal case of a *res*, based on Rahmatian's theory, since they are, by their very nature, the product of a legal abstraction. The fact that they are transferable, or are treated as personal property (choses in action) in English law, only goes to support Rahmatian's views; but those points do not establish that it is a system-neutral idea.

Based on Rahmatian's theory, since a claim is a *res* and is thus presumed to be so because of the real rights attached to it, this implies that it ought to attract property-like protection despite the fact that it arises from a personal right. Rahmatian argues in this regard that: while the debt or claims give rise to personal rights and are enforceable between the parties *inter se*, ' [t]he obligation is a (proprietary) asset and it is protected by tort law, particularly the tort of knowingly procuring (inducing) a breach of contract that is directed against third parties, similar to a property right which is – in England — protected through torts as well'.[633] This protection is in line with Rahmatian's 'external side' of the real rights, which, as mentioned in section 5.4.1, materialises in the right of exclusion of the object (obligation-*res*).

[629] ibid 11–12; Rahmatian, 'IP and Dematerialised Property' (n 20) 365.
[630] Rahmatian, 'Debt' (n 497) 212.
[631] ibid.
[632] Relating to the assignability, as earlier argued, it is questionable whether it is indeed an indicator of a real right.
[633] Rahmatian, 'Debt' (n 497) 211.

Another way of putting the above point is that while between the creditor and debtor, the obligation is a personal right, private law attaches real rights to the claims by protecting it through the torts of inducing a breach directed at third parties. This argument is similar to Reid's and Benjamin's core arguments. Reid argues that in owning personal rights such as a debt 'the real right defines the relationship between [a person] to the debt; the personal right defines the relationship within the debt [….]'[634] Essentially the real right attaches to the debt (res) with the implication that the right can be enforced against third parties. The personal right is between the parties *inter se*. Benjamin likewise, as earlier mentioned, argues that '[A]s against the debtor, the creditor can only assert personal rights in relation to the debt'.[635] However, they can be the subject of a property right as against someone other than the obligor.[636] She adds that this leads to the conclusion that real and personal rights are not inherent in the asset; they are dependent on whom one is suing. This conclusion seems like Rahmatian's above: that is, between the creditor and debtor, it is a personal right, but between the creditor and third parties it is a real right. However, Rahmatian may disagree with Benjamin on the point that property is dependent on the person rather than the *res*. He may argue that for a real right, the 'relations between persons [must be] with respect to things as the law imagines and organises them'.[637]

However, even if Rahmatian was to hold the above view, his counterargument against Benjamin will stem from a misunderstanding of Benjamin's position. Benjamin may agree that real rights are rights in a *res*. However, she may say that when she argues that property is a function of action rather than assets, she is making that argument to extend the kinds of assets which are susceptible to property rights, that is, corporeal and incorporeal, rather than whether things are broadly the object of property. Thus, unlike the Pandectists above, she may argue that property is not defined in terms of corporeal assets, but in terms of its exigibility against third parties in respect of both corporeal and incorporeal assets. Thus, her contention is with respect to the corporeality or otherwise of the *res*, rather than whether a property right relates to objects. Therefore, this essentially is not different from Rahmatian who defines real rights to claims in terms of their protection against third parties, regardless of whether the asset is corporeal or incorporeal.

[634] Reid (n 307) 230.
[635] Benjamin (n 258) 13.10.
[636] ibid 13.51.
[637] Rahmatian, 'IP and Dematerialised Property' (n 20) 367.

Secondly, it does not follow that a right is a real right merely because it is protected through an action in tort. As Gretton argue, legal systems may protect personal rights if a person breaks his promise as a result of collusion.[638] But this does not imply that the protection results from a real right. The idea that because claims are reified as *res* that the protection ought to be a property law protection may not matter much. This is because the debt itself is not intrinsically valuable. It is only valuable because it is exigible against a particular person, unlike a real right in a corporeal thing which follows the objects into the hands of any successor. Therefore, the underlying claim is personal were we to remove the disguise of the 'res' attached to the debt. As Mincke points out 'It is useless to put relationships into a hat and then pull out an object'.[639]

There are several factors that give rise to the temptation to define property in terms of its exigibility against third parties. The first is the Hohfeldian definition seen earlier, which as noted, defines a right *in rem* in terms of the party against whom it is exigible. While Benjamin acknowledges the impact of this definition to her approach,[640] Rahmatian is critical of Hohfeld, arguing rightly that Hohfeld's relational definition gives a false impression of real rights as being 'merely particular manifestations of personal right'.[641] But Rahmatian likewise falls into the same trap in arguing, as above, that obligations give rise to personal or real rights depending on who one is suing.

Secondly, it is possible that because both Rahmatian and Benjamin treat incorporeals as property objects [642], the *res* and its characteristics become unimportant in differentiating the external boundary of real rights in contrast to personal rights. Because both personal and real rights are relational, it is difficult to map out a distinction between obligation and property, or personal and real rights, based on the *res* which in substance is a personal right. As earlier observed, this is the problem Windscheid tries to avoid. Consequently, this gives rise to the temptation to demarcate the boundary based on who one is suing , rather than on the nature of the asset.

Why does this matter? As Rahmatian acknowledges, defining real rights in terms of their relational effects, or rather parties against whom they are exigible, gives a false impression that real rights are 'merely particular manifestations of personal rights'. [643] But the argument

[638] Gretton, 'Trusts without Equity' (n 306) 602.
[639] Mincke (n 304) 85.
[640] Benjamin (n 258) para 13.55.
[641] Rahmatian, 'IP and Dematerialised Property' (n 20) 365.
[642] Benjamin (n 258) para 13.58.
[643] Rahmatian, 'IP and Dematerialised Property' (n 20) 365.

here is that this is not a significant concern if it is admitted that a) the underlying basis for the debates in this chapter, especially from the Pandectist angle is the protection of the boundary between property and obligation ; b) that while the Pandectist's arguments are intended to maintain that boundary, both Rahmatian's and Benjamin potentially do not ; c) closing that boundary is not a concern if it is accepted that systems, such as English law, as endorsed by Rahmatian and Benjamin, apply a different definition of a real right which pays minimal attention to the nature of the *res*, in line with Hohfeld's definition. Obviously, this approach is broader, unlike the German or Dutch law approach which provides an alternative concept, as seen below. This argument implies that the idea of ownership of claims is not system-neutral.

However, it may be said that despite the differences between Rahmatian and the Pandectists, they agree on certain things. They define real rights as legal creations. For example, Pretto-Sakmann, like Rahmatian, notes that 'rights *in rem*, alias property rights, are themselves incorporeal'.[644] This idea seems also to be shared by both Gretton and the Pandectists, who, as noted, define patrimony as including legal rights and concepts. Gretton also notes, like Rahmatian, [645] that the objects of the patrimony and transfer are rights, real or personal, not physical things.[646]

Despite this similarity, they obviously differ in many respects already discussed above. In addition to this, Gretton, as well as Honoré, may disagree with Rahmatian that a person can own an estate in land. The concept of estate is defined as the totality of rights or interests a person has in a land.[647] Because ownership is a right – a fact acknowledged by Rahmatian [648] — and an estate is likewise a right, it is therefore, as earlier mentioned, 'doubly misleading'[649] to state that a person can have a right (ownership) in a right (estate) in land. Also, if a person can have a right in a right (i.e. conceptualised as a thing), what stops her from owning ownership which is a right? [650]

As earlier mentioned, Rahmatian may argue that any talk about owning ownership is useless because the concept of ownership presupposes an object owned: that is, property right presupposes a property object. Therefore, it is meaningless to ask if ownership can be owned,

[644] Pretto-Sakmann (n 502) 99.
[645] Rahmatian, *Copyright and Creativity* (n 309) 11.
[646] Gretton, 'Ownership and Its Objects' (n 307) 831.
[647] Charles Harpum, Stuart Bridge and Martin Dixon, *Magarry & Wade: The Law of Real Property* (8th edn, Sweet & Maxwell Ltd 2017) para 2.005.
[648] Rahmatian, *Copyright and Creativity* (n 309) 7.
[649] Honoré (n 18) 134.
[650] ibid.

since the right presupposes a property-*res*. As Rahmatian admits, there is a circularity in defining the objects of a property right by the real right itself.[651] However, while this *petitio principii* rightly reflects the close relationship between real rights and their objects, it does not stop us from attempting to identify the nature of the object or *res*: things or rights? In other words, we cannot say it will be circular to identify the nature of the *res* which is presupposed by a real right. In this light, Gretton may indeed, like Rahmatian, acknowledge that a real right presupposes a *res* (i.e. thing). However, he may argue that this does not mean that it attaches to an incorporeal object such as a right. [652]

Regardless of the position one takes, there is a consensus between the Pandectists *et al* and Rahmatian et al: that is, a) that the creditor's right in both cases may be vindicated, and b) that the creditor can transfer the assets or create a security right over them in favour of a creditor. While the Pandectists, Gretton and Pretto-Sakmann achieve this effect through a route which maintains the boundary between property and obligations, Rahmatian, as well as Benjamin, whose positions find support in English law and tentatively other systems [653] which recognise real right in incorporeals, get to that same effect through a route which erases that well established distinction. For systems such as English law, this may not be a concern since there is no strong drive to maintain that boundary. This can be seen in the case of an equitable right, which as we saw in the previous chapter, primarily acts *in personam.*

Nonetheless, can it be said that because the practical effects of both views above are similar, that this implies that we can identify some system-neutral ideas? As we will argue in the next section in relation to the provisions of the Collateral Directive, this is dependent on the definition of the term 'full entitlement', which the Directive uses as a synonym for 'full ownership'.

6.6 THE COLLATERAL DIRECTIVE: FULL OWNERSHIP AND FULL ENTITLEMENT AS ALTERNATIVES?

As argued in chapter two, there are presuppositions in the Directive that its norms are system neutral. This presupposition is dependent on the definition of a TTFCA which, as seen earlier, is defined as the transfer of full ownership of, or full entitlement to, financial collateral to a collateral taker. Indeed, looking at the definition, it connotes that financial collateral, or

[651] Rahmatian, 'IP and Dematerialised Property' (n 20) 365.
[652] Gretton, 'Constructive Trust' (n 343) 831.
[653] Erp, 'European Property Law: A Methodology for the Future' (n 7) 13. Writing from the perspective of Dutch law, Sjef van Erp argues that the division between personal and real rights are no longer considered to be 'watertight compartments'. He endorses that claims can be the objects of a real right.

claims, can be the object of ownership (real rights) – in line with Rahmatian's argument, and as such that this idea is system-neutral. However, this may not be correct as will be argued below. Any view on this issue is dependent on how we interpret the phrase 'full entitlement' which is included in the definition of a TTFCA.

In summary, the following argument will be made below. Although the term 'full entitlement' is not defined in the Collateral Directive, there are suggestions that it is used to denote the relationship between a person and his right (titularity), in the same way that Gretton uses the term. Thus, although using both terms (i.e. full ownership and full entitlement) in the same sentence/definition will suggest that the Collateral Directive perceives the issue to be system-dependent, this may not be accurate. Instead, it seems to be that the Collateral Directive uses both terms in the presupposition that they have the same effects. Thus, in line with the functional methodology behind Directives, the effects are the key thing. Sjef van Erp makes a similar suggestion, though in a different context, that the idea of ownership and entitlement have the same content and thus suggests that collateral can be the object of property.[654] However, even as discussed below, some of the contents of these rights are not equivalent, implying that they can only be seen within their respective contexts.

6.6.1 THE COLLATERAL DIRECTIVE: CORPOREALITY, INCORPOREALITY, OR FLEXIBILITY?

Adopting any of the approaches discussed in this chapter implies that a fragmented approach is taken regarding the question. Thus, it will imply that one doctrinal approach is endorsed in opposition to an equally valid doctrine. This contradicts one of the assumptions of the functional method, which aims to find a system-neutral meaning, based on the effects of different institutions. This is also the aim of the Directive, as discussed in chapter three. Therefore, endorsing one principle which may be predominant in one system [655] in opposition to an equally valid approach which is adopted in another system [656] contrasts with the 'universalisation function' of the functional method.

Although the scholars all argue as if their views are analytical and system-neutral, they are in fact system-dependent if we are to accept that their different views find support in

[654] Erp, *Osmosis or Antagonism* (n 550) 18; Erp, 'Deconstruction' (n 508) 116.
[655] The doctrinal approach advocated by Rahmatian finds support in English law, as seen from his writings where he consistently refers to English law.
[656] The Pandectist approach finds support in the German Civil Code and to some extent in the Dutch Civil Code.

different systems. Nonetheless, although not expressly stated in the Directive, there are suggestions that the Directive does not adopt one view in contrast to the other, but treats the different approaches, as espoused by these scholars, as having some functional similarities, on the basis of which a system-neutral idea can be identified. This suggestion is premised on the meaning of the phrase 'full entitlement'. The phrase did not appear in the 2002 version of the Collateral Directive.[657] In that version, a TTFCA was defined as the transfer of full ownership of both cash and financial instruments from a collateral provider to a collateral taker. However, in 2009 the scope of the Directive was amended to extend it to credit claims in addition to cash and financial instruments. The amendment also added the phrase 'full entitlement' to the definition of a TTFCA. Based on the literal drafting, the new definition suggests that the phrase is a synonym for the phrase 'full ownership'. Therefore, the phrase 'full entitlement' can be used interchangeably with the phrase 'full ownership'. However, the European Commission, in its proposal to the amendment of the 2002 version, noted that the words 'full entitlement to' are added to distinguish ownership of cash and financial instruments on the one hand and entitlement to credit claims on the other hand.[658] This suggests that 'full entitlement' is restricted to credit claims. However, the European Commission does not state the basis for this distinction, but this suggests that it acknowledges that credit claims may not be the objects of ownership.

While the phrase 'full entitlement' is not defined, the Directive defines credit claims as pecuniary claims whereby a credit institution, for example a bank, grants credit in the form of a loan. Therefore, the Collateral Directive permits such loans to be used as collateral as an 'alternative to securitisation'.[659]

The drafting of the amendment belies the reasons proffered by the European Commission. Although the European Commission proposed that the phrase be used exclusively in relation to credit claims, the definition of TTFCA suggests that it applies to financial collateral generally, which refers to cash, financial instruments and credit claims. However, in construing EU directives, the *travaux préparatoires*¸ including European Commission proposal is used in the preparation process, are an important interpretation document. Consistent with this, the conclusion can be reached that regardless of the drafting of the amendments, the intent, as stated in the European Commission proposal, is the most appropriate interpretation.

[657] Directive 2002/47/EC on Financial Collateral Arrangements.
[658] EC, 'Proposal for Amendment, para 6.2.2.
[659] Gullifer, *Goode and Gullifer* (n 275) para 6.06.

Therefore, while the right of ownership relates to cash and financial instruments, the concept of 'full entitlement' relates to credit claims.

Conceptually, there may be no need to distinguish between the different types of collateral. The law treats them all as claims arising from an obligation. As Rahmatian notes, the active side of this obligation is called claims.[660]

Thus, rather than distinguish between the different types of financial collateral, a distinction needs to be made between the concepts of 'full ownership' on the one hand and 'full entitlement' on the other hand. This is because credit claims, as seen above, are conceptually a 'claim', and since the European Commission restricts the phrase 'full entitlement' to credit claims, there is the presupposition that, at least, some systems do not recognise real rights in claims. However, before we can conclude this, it is important to identify the meaning of 'full entitlement'.

Neither the Directive nor the preparatory document to the amendments contain any definition of this term. However, the concept is not new. The Dutch Civil Code, which has the same narrow approach as German law, is familiar with a concept of 'entitlement' of claims to somebody [*toebehoren*].[661] Snijders and Rank-Berenschot note that this concept 'does not fall under the definition of ownership [under Dutch law]'. It is instead defined as 'the most extensive right on a right'.[662] This is similar to Gretton's concept of titularity, which he defines as the relationship between a person and his right, including personal rights. Pretto-Sakmann also defines it as a 'relation between every right *in personam* and the person entitled to the benefit of its realisation'.[663] She adds that the concept is used to describe 'the fact that an entity belongs to someone [and that] "my share" and "my debenture" are not propelled into the law of property by the possessive which highlights the entitlement relationship'.[664] According to her, '[t]he entitlement relationship between me and that personal claim, or, in other words, the fact that personal claim belongs to me, is more often expressed in the form 'I say that you ought to pay me £1000'.[665] The concept is therefore used in contrast to the ownership of corporeals, to refer to the relationship between a person and his rights, including claims.

[660] Rahmatian, 'Debt' (n 497) 209.
[661] Erp and Akkermans (n 330) 382.
[662] HJ Snijders and Rank-Berenschot, *Goederenrecht* (Kluwer 2001) n 207; cited in Erp and Akkermans (n 330) 382.
[663] Pretto-Sakmann (n 502) 204.
[664] ibid.
[665] ibid 205.

The Collateral Directive seems to use that term to refer to the relationship between a counterparty and the collateral. But what is the implication of this in relation to the question in this chapter? On the one hand, it may be argued that using 'full ownership' and 'full entitlement' as alternatives presupposes that the idea of ownership of claims is not system neutral. The Directive recognises that systems approach the same issues differently. This implies that Rahmatian, Reid and Benjamin are to an extent correct, since the Directive acknowledges the possibility of owning collateral. On the other hand, the use of the term 'full entitlement' also implies that the Directive acknowledges that ownership may be restricted to corporeals, as espoused by Gretton and Pretto-Sakmann. For this reason, it provides the concept of entitlement as an alternative to ownership.

Although the above view may seem right, an alternative view may be equally be proffered: i.e. when the Directive uses the term 'full entitlement', it presupposes that the effects of the concept are the same as the concept of ownership. This view finds support in the function which a TTFCA performs. Essentially, this implies that we need to understand those concepts in terms of the effects of the transaction (TTFCA), rather than on whether the terms are provided by the Directive in recognition of the differences in systems.

Thus, as discussed in the previous chapter, a TTFCA is said to perform two functions: tradability and recoverability.[666] As argued, the most important function is the tradability function which is normally the consequences of an ownership right. As argued, this function implies that the collateral taker, as noted by Keijser, has an 'unlimited right to dispose' and deal with the collateral.[667] Thus, he can create a security right or dispose of it the way it likes. The Directive partly confirms this fact in the definition of an SFCA, which is discussed in chapter nine, in that it presupposes that a person who has the full entitlement in a claim can create an SFCA over the collateral 'by way of security', while retaining the full entitlement.[668]

This position taken under the Directive appears to endorse the views of Sjef van Erp who similarly argues that the contents of the concepts of entitlement and ownership are the same in particular reference to the fact that the right holders may transfer, create a security right or grant a usufruct over claims. Thus, within the context of a TTFCA, this presupposes that the concepts of entitlement have equivalent effects to ownership.

[666] Keijser (n 96) 133.
[667] ibid 175.
[668] See Article 2 (1) (c) of the Directive.

These views are in tandem with the observations earlier highlighted in this chapter. Thus, as shown, the two approaches agree that both full entitlement and full ownership have certain equivalent effects. An owner or holder of a claim can assign it or create, as Gretton notes, a limited personal right on the asset. Both concepts also confer on the owner or right-holder the right to vindicate the claim against a third party in some instance. However, while Gretton and Pretto-Sakmann may agree that the two concepts give rise to effects some of which are similar, they may however disagree with the way the concepts are used by the Directive as if the two concepts are the same in terms of *all* their effects: particularly in relation to the right of unlimited disposal of the collateral , as Keijser argues above. Gretton may argue that a limited right (i.e. security right) created over financial collateral is not a limited real right, but a limited personal right. This is because, as earlier suggested, the daughter (limited) right has the same structure as the primary right it burdens. Thus, a security right or usufruct over a claim will itself be a personal right.[669] By implication, even if it is suggested that the property law ideas of *usus,*[670] *fructus* [671] and *abusus*[672] can in some functional way apply to claims, it is debatable to what extent that will actually be the case, since the structure of the secondary rights will normally be the same as the structure of the primary right. This is buttressed by the fact that, as suggested by Ghestin *et al* 'the creditor, compared to an owner, does not have the power to extinguish the right to receive payment of a debt, which, however, would correspond to the right to dispose of a thing [….]'[673] Primarily, the debtor can oblige a creditor to accept payment that he no longer wants. We can say that this necessarily arises because, as earlier argued , for claims, there is nothing for the burden to follow apart from the person. The internal structure of the right is personal, thus the benefit and burden of the right is always personal, meaning that, in contrast to what the Directive and Keijser presuppose, it is not possible to conceptually say that a collateral taker has an unlimited right of disposal in the same way as an owner. Thus, this implies that it may be inaccurate to conflate the two terms in one definition as if they have equivalent effects.

6.7 CONCLUSION

The argument in the chapter is that it is not system-neutral or self-evident that financial collateral can be the object of full ownership. Although this sounds counter-intuitive, especially in the context of the financial markets, the chapter has demonstrated why the contrary belief is not entirely accurate. Drawing from the contrasting approaches examined in the chapter, certain

[669] Gretton, 'Ownership and Its Objects' (n 307) 839.
[670] Right to personally use the asset, by creating a security right for example.
[671] For example, a right to receive dividends from a share.
[672] For example, a right to transfer or extinguish the right by some other means.
[673] J Ghestin, M Billiau and G Loiseau, *Le Régime Des Créances et Des Dettes* (LGDJ 2005) no 11-13; cited in Erp and Akkermans (n 330) 369.

arguments were made to support this conclusion: first, that the two approaches define real rights differently, paying attention in varying degrees to the property/obligation boundary. One implication of the first approach is that it is meaningless to functionally define objects of right based simply on the concepts of transferability or that on the fact that rights can be vindicated or simply on the contents of the rights. On the other hand, the second approach which implicitly pays less attention to this boundary distinguishes a property right from personal right in terms of who the rights are exigible against. In this regard, the argument was made that one implication of this is that, as Rahmatian rightly notes, it represents a property right as a manifestation of personal rights. This is so notwithstanding that there is a claim-*res* over which such real rights are held: the burden of the right follows a person. Although the second approach blurs the distinction between property and obligation, it was argued that this is not a problem if it is acknowledged that systems, such as English law, where this approach is dominant tend to pay less attention to that distinction. Essentially, what this suggests is that the exact objects of ownership are based on conventions.

It was further argued that although the Directive uses the concepts of entitlement and ownership as if they are equivalent, this is not so in all cases. For example, in relation to the right of disposal (*abusus)*, the creditor in a claim (entitlement), compared to an owner, does not have the power to extinguish the right to payment. The underlying basis for this, it was argued, is because for claims, the internal structure of the right is personal. This discussion points towards the fact that the doctrinal context is important.

7 CHAPTER SEVEN: TTFCA AS *FIDUCIA CUM CREDITORE*?

7.1 INTRODUCTION

In chapter one, the functional method and its assumptions were examined. It was noted that the method is based on certain assumptions: first, that the principle of functionality is the key consideration in comparative law; secondly, that that problems and solutions are presumed to be similar; thirdly, that legal institutions may be defined by their effects without attachment to doctrinal context. This suggests that the context does not matter regarding how particular results are achieved.

Furthermore, in chapter three, it was argued that the primary objective of the Collateral Directive was to prevent a TTFCA from being recharacterised. This was a problem present in some legal systems that voided a TTFCA or applied the rules on publicity for the creation of security devices to such transactions. To prevent this, and to achieve a uniform result in the EU, the Directive required Member States to legitimise a TTFCA and to disapply restrictions applied to it.

The above is the core objective of the Directive. Importantly, this core objective is dependent on the concept of a TTFCA which is defined in Article 2 of the Directive as:

> [A]n arrangement, including a repurchase agreement, under which a collateral provider transfers full ownership of, or full entitlement to, financial collateral for the purpose of securing or otherwise covering the performance of relevant financial obligations.

As seen in chapter three, the legal structure of the EU makes it necessary to define legal institutions in a system-neutral way, since the various systems have different doctrinal structures. To define a legal institution in a doctrinal way potentially removes it from some domestic legislative framework. The theoretical basis for this, as argued, is the functional method which defines legal institutions in a system-neutral way.

In view of the above, the above definition of a TTFCA ought to be system-neutral without any doctrinal commitment. This is to make it possible for systems to easily recognise the arrangement. The question therefore in this chapter is whether the TTFCA, as a concept, can be seen simply in the light of its particular function or effect (i.e. as a transfer of full ownership for a security purpose).

Chapter five considered the conceptual underpinnings of the right conveyed in a TTFCA (i.e. full ownership). This chapter addresses the more concrete question of how a

TTFCA is understood in the Directive. The answer to this question lays the groundwork for the next chapter which considers the position in English law in relation to the UK Implementing Regulation.[674] to determine if the provisions of a TTFCA match the equivalent provision in the Regulations.

The chapter is divided into two sections. The first section examines the drafting of the Directive above on TTFCA to identify its meaning. The second considers the corresponding drafting in the UK Regulations as they are understood in Scots law. We use Scots law to access the broader Civil law system on TTFCA, and to affirm that a TTFCA, in the Directive, refers to a *fiducia cum creditore.*

7.2 THE DIRECTIVE, CONDITIONS OF APPLICABILITY AND *FIDUCIA CUM CREDITORE*

The Collateral Directive is structured in a way that contrasts a TTFCA from an SFCA. Both transactions are entered into for the purpose of providing collateral for a debt and therefore this raises the question of the relationship between a transfer and a security in the context of the Directive.

A distinction may be drawn between a 'proper security' and an 'improper security'.[675] Both devices refer to arrangements which the law recognises as performing a security function. A proper security is an arrangement such as a pledge in Civil law systems or a possessory pledge in English law, which creates a limited real right. On the other hand, an improper security refers to an arrangement, in many Civil law systems, under which ownership is used as security device to secure a debt.[676] This will include a *fiducia cum creditore*. Importantly, the idea of an improper security, as will further be argued below, explains why a TTFCA may be seen as a security arrangement in the Directive.

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[674] Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226), as amended by the Financial Collateral Arrangements (Amendment) Regulations 2009 (SI 2009/2462) and the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010 (SI 2010/2993) ('FCAR').

[675] These terms are borrowed from the Scottish Law Commission *Discussion Paper on Movable Transactions,* 43. Smith points out that the terms are a 'wonderful pair of terms' unique to Scots law. Lionel Smith, 'Powership and Its Objects' in Andrew Steven, Ross Anderson and John MacLeod (eds), *Nothing So Practical as a Good Theory: Festschrift For George Gretton* (Avizandum Publishing Ltd 2017) 227.

[676] For a brief history of a *fiducia cum creditore* as a security device, see: Ivan Mangatchev, 'Fiducia Cum Creditore Contracta in EU Law' (2009) 1–19 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1474199> accessed 13 September 2017; Donald Phillipson, 'Development of the Roman Law of Debt Security' (1968) 20 Stanford LR 1230, 1234.

Many legal systems treat a *fiducia cum creditore* differently from a simple transfer not made for a security purpose. In Netherlands, a *fiducia cum creditore* is completely prohibited.[677] In Belgium, it is a valid transfer but does not have any third-party effects.[678] German law treats it like other transfers but subject to restrictions — for example, during insolvency, the arrangement is treated as a pledge, with the effect that the assets are still within the transferor's patrimony. [679] Scots law, as further discussed below, recognises it as a valid transfer, although it is subject to the publicity requirement under Part 25, Companies Act 2006 as a charge.

Given the distinction between proper and improper securities, it might seem obvious that the distinction in the Directive between a security arrangement and a TTFCA indeed mirrors this distinction in many Civil law systems between a *fiducia cum creditore* and a pledge.[680] Essentially, the nature of an *fiducia cum creditore*, i.e. as a transfer of ownership for a security purpose, draws it closer to a TTFCA in the Directive.

Keijser disagrees. He argues that a TTFCA is not a *fiducia cum creditore* because the collateral taker in a *fiducia cum creditore* does not have the right to use the collateral. He argues that a TTFCA in the Directive is instead an outright transfer of collateral which confers a right of use on a collateral taker.

It is important to note that Keijser's views are based on Dutch law which historically has taken a mixed approach to the *fiducia cum creditore*. Under Dutch law before 1992, a *fiducia cum creditore* was recognised as a transfer. However, subsequent changes brought about by judicial decisions,[681] under pre-1992 Dutch law, limited the rights of the collateral taker and functionally converted it into a proper security by applying, by analogy, the rules applicable to a pledge to such devices. First, the assets which were transferred automatically fell back into the assets of the collateral provider upon the discharge of the secured transaction. Secondly, the fiduciary also had a limited right of disposal because he could not, for example, transfer full title to a third party. Furthermore, pre-1992 Dutch law extended the pledge rules which applied to limited real rights in the event of default to the *fiducia cum creditore*. This

[677] Article 3.84(3) of the Dutch Civil Code.
[678] *Vanden Avenne-Ooigem v Landbouwkrediet, Flemmish Community, Insolvency Administrator of RB* [2010] Nieuw Jurid Weekbl 834, 834; see also Erp and Akkermans (n 330) 510.
[679] On the restrictions in German law, see Akkermans, *The Principle of Numerus Clausus in European Property Law* (n 278) 186–190; see also Erp and Akkermans (n 330) 518.
[680] Gretton, 'Financial Collateral' (n 263) 213–214.
[681] On the Dutch law and the limitations placed by the Dutch Supreme Court (*Hoge Raad*), see: Keijser (n 96) 117–119; see also the useful discussion in Akkermans, *The Principle of Numerus Clausus in European Property Law* (n 278) 263–269.

meant that where the collateral taker sold the collateral in the event of default, any surplus would be returned to the collateral provider based on mandatory pledge rules. Furthermore, the rights of the collateral taker were not always enforceable against other creditors, especially where the collateral was transferred by constructive possession (*constitutum possessorium*). These limitations were extended under Dutch law to the *fiducia cum creditore* to bring it closer to proper securities. However, in 1992, the *fiducia cum creditore* was completely prohibited under Dutch law. This prohibition, as Keijser notes, was based on the ground *inter alia* that the transaction was a secured transaction and distorted the balance which is fundamental to such transactions: the transaction transferred ownership and therefore had the potential to give the creditor more benefits at the expense of the debtor.

The pre-1992 Dutch law approach to the *fiducia cum creditore* therefore forms the background to Keijser's views who argue that a TTFCA under the Directive is not a *fiducia cum creditore*. According to Keijser, a TTFCA under the Directive performs two functions seen in section 5.5: tradability and recoverability. While a *fiducia cum creditore* performed the latter function of recoverability, it did not perform a tradability function because the collateral taker, under the limitations in the pre-1992 Dutch law, had a limited right of disposal.[682] Keijser therefore observes that based on the pre-1992 Dutch law limitations, a fiduciary transfer could not qualify as a TTFCA because it was functionally seen as a security interest which had limitations unlike a TTFCA which transferred ownership unconditionally. Keijser adds that if a *fiducia cum creditore* was to be recognised as a TTFCA in accordance with its terms, as provided by the Directive, this means the arrangement favours collateral takers who are in a stronger position, as earlier noted.

In essence, what Keijser argues is that a TTFCA, as understood in the Directive, is not a *fiducia cum creditore*. Instead, it is an outright transfer of ownership. Keijser therefore sees a clear distinction between a TTFCA and an improper security (*fiducia cum creditore*) because of the restrictions in the old Dutch law. There is therefore, as his view will suggest, a clear conceptual difference which makes it unnecessary to have the provisions of the Directive on recharacterisation of TTFCA. In other words, the provisions of the Directive on a TTFCA provides a situation where a *fiducia cum creditore* is not needed.

In considering both Keijser's views and the alternative views below by Gretton and under English law, it is important to note that there is no dispute as to what counts as a TTFCA. Keijser, as well as Gretton below, all seem to agree that a TTFCA in the Directive a) transfers

[682] Keijser (n 96) 94.

ownership and b) for a security purpose. This mirrors the position under English law. However, the dispute arises in relation to the scope of a *fiducia cum creditore* and whether it is a TTFCA.

Keijser's conclusion can be argued to be too narrow since his focus is Dutch law. Thus, because there was no tradability function in a *fiducia cum creditore*, Keijser takes the view that such an arrangement is not a TTFCA in the Directive. Apparently, this conclusion is premised on the peculiarities under the pre-1992 Dutch law. Therefore, any conclusions based on that can only have a narrow application to Dutch law. It offers little guidance in determining whether a *fiducia cum creditore* is a TTFCA at the wider European level. As will be seen below, some legal systems, such as English and Scots law, essentially adopt a broader approach to this issue. For this reason, the provisions of the Directive on the TTFCA is primarily aimed at such systems, though it will further be contended below that the Directive indeed applies to Dutch law regardless of its narrow approach to a *fiducia cum creditore*.

As mentioned, English law is an example of a system which takes a broader approach. Goode and Gullifer note that a transaction will be a TTFCA in so far as the parties genuinely intend to transfer ownership, even if for a security purpose.[683] According to Goode and Gullifer, provided that the transaction transfers 'full ownership on the transferee, as opposed to a mere security interest, the transaction will be characterised according to its description and will not be recharacterised as a security agreement'.[684] The economic or functional effects of a transaction does not matter. What matters is the genuine intention to transfer ownership.

However, there is a question regarding how to identify if ownership is genuinely transferred in a TTFCA under English law. Notably, in *Re George Inglefield Ltd* ,[685] Romer L.J answered this question from a negative perspective, that ownership will not be transferred where: one, the debtor has the right to retrieve the asset upon the discharge of the amount owed; secondly, where the creditor is under obligation to account to the debtor for any surplus realized from the sale of the assets; [686] and thirdly, where the creditor is entitled to recover any shortfall after the charged collateral has been sold. Similarly, in *Beaconwood Securities Pty v Australia and New Zealand Banking Group Ltd* [687] the court held that ownership is genuinely transferred in a TTFCA where: first, the title in the collateral is transferred unencumbered to the collateral taker; secondly, on termination there is no obligation to return the securities *in specie* unlike under a security interest;

[683] Gullifer, *Goode and Gullifer* (n 275) para 1.41.
[684] ibid.
[685] *Re George Inglefield Ltd* [1933] Ch 1, 27–28.
[686] See also Law of Real Property Act 1925, s.105 which requires a chargee to render account for any surplus from the sale of the charged assets.
[687] *Beaconwood Securities* (n 287).

thirdly, where the collateral taker is free to use the collateral as he likes unlike under a security interest where the collateral taker cannot do so.

These are factors to be considered in identifying whether ownership is transferred. In any event, once the court finds that ownership is genuinely transferred, even if for a security purpose, such an arrangement is a TTFCA. Therefore, this situation contrasts with Dutch law before 1992 when regardless of whether ownership is genuinely transferred, a *fiducia cum creditore* was still recharacterised as a security right.

Scots law, as further discussed in the next section, adopts a broader approach to a *fiducia cum creditore*. Gretton, arguing from the perspective of Scots law, points out that a *fiducia cum creditore* is a TTFCA in the Directive. He notes that in a *fiducia cum creditore*, 'the grant of "full ownership" is the whole basis of [the] secured transaction', and that the collateral provider retains some personal rights.[688] According to Gretton, the whole purpose of the Directive was to legitimise a repurchase agreement which is a secured transaction in the form of a *fiducia cum creditore*. Although repo agreements are normally expressed in terms of sale and repurchase, Gretton notes this approach is often adopted 'precisely because the markets do not want the transactions to be subject to mandatory rules of national laws about secured transactions'.[689] In Gretton's view, this is what the Directive sought to achieve: to ensure that such transactions (*fiducia cum creditore*) are recognised as such without applying the mandatory rules that apply to proper securities.

The definition of a TTFCA in the Directive, as provided earlier, does not state whether a *fiducia cum creditore* is a TTFCA. A question then arises as to whether based on the above definition in the Directive a *fiducia cum creditore* may be said to be a TTFCA. Gretton notes that the words 'for the *purpose of securing* or otherwise covering' in the definition seems to 'lead inexorably to the conclusion that at least some type of TTFCAs are secured transactions' in the form of a *fiducia cum creditore.*[690] Recital 13 also seems to support this position. The Recital states that one of the aims of the Directive is to ensure the protection of financial collateral arrangements that 'are based upon the transfer of the full ownership of the financial collateral, such as by eliminating the so-called recharacterisation of such financial instruments (including repurchase agreements) as security interests'.

[688] Gretton, 'Financial Collateral' (n 263) 217.
[689] ibid 218–219.
[690] ibid 219.

It is difficult to understand this Recital if it is accepted that a *fiducia cum creditore* is not a TTFCA, as Keijser suggests for Dutch law. As earlier noted, legal systems give different responses to a *fiducia cum creditore*. There is often a risk of recharacterisation because of the compound nature of the arrangement: on the one hand, it transfers ownership; on the other hand, parties often wish to use the ownership as security. The transaction may therefore be seen as a disguise. Because systems take different approaches to this issue, Article 6 of the Directive, in giving effect to Recital 13, provides that 'Member State shall ensure that an arrangement shall take effect in accordance with its terms'. This requires that such transactions are not to be recharacterised as a pledge.

It may be said that the Directive by this provision is targeted at systems which adopt a functional, rather than a formal approach, to the recharacterisation of a *fiducia cum creditore*. Generally, a functional approach, as seen in section 4.2.1, is an approach which defines what constitutes a security right based on the effect of the transaction to secure the performance of a transaction. In a formal approach the key consideration is whether ownership is genuinely transferred as seen in English law. Therefore, in a formal approach, where the transaction transfers ownership, for example, in a *fiducia cum creditore,* such a transaction ought not to be treated as a security.

The Directive adopts both a functional and formal approach. The Directive adopts a functional approach in identifying what transactions amount to a TTFCA. However, it adopts a formal approach in focusing on the rights of the parties to apply certain consequences. By implication, a formal approach is applied for the purpose of disapplying the rules highlighted in chapter one, such as the rule on publicity or other restrictions placed on such a transfer by a system. But a functional approach is adopted to identify the transaction, i.e. whether a) ownership is transferred?[691] b) , and is it for a security purpose? A transaction must have these two effects to come within the scope of the Directive. Thus, once the purpose of the transaction is identified, a formal approach is applied to treat such a transaction as actually creating the right which it purports to create.

In the case of a *fiducia cum creditore,* this means that once it is identified that ownership is transferred for a security purpose, the Directive, by Article 6, mandates Member States to give effect to the right created by the parties.

[691] That is, if it is accepted personal rights can be the object of ownership. This controversy has been discussed in the previous chapter.

The above may be applied to Keijser's argument regarding the *fiducia cum creditore*. If, as Keijser argues, a *fiducia cum creditore* is to be seen narrowly because of the restrictions under the pre-1992 Dutch law, even that narrow interpretation may qualify as a TTFCA in terms of the Directive. The reason for this is that Keijser may be mistaken, because he takes the consequences of applicability (tradability function) as a condition of applicability of the provisions of the Directive. The tradability function is a consequence and not a condition of applicability. It arises only when it is identified that ownership is actually transferred. As argued above, there are primarily two conditions of applicability in the Directive, i.e. a) a transfer of ownership b) made for a security purpose. Once these two requirements are met, then the consequences in the Directive ought to apply. These consequences which are mentioned in the section 1.2 include disapplying the restrictions on the *fiducia cum creditore* placed by old Dutch law, such as the pledge rules on publicity or restrictions on tradability. Thus, once a transaction meets the conditions for applicability, the consequences of disapplication follow.

7.3 THE UK REGULATIONS: TTFCA AS LEGAL AND BENEFICIAL OWNERSHIP

As noted above, the Directive applies two conditions of applicability for identifying a TTFCA, i.e. a) full ownership must be transferred and b) for a security purpose. These two conditions, as argued, are not synonymous with the consequences of applicability in the Directive. The primary question below is whether the definition of a TTFCA, based on the two conditions of applicability in the Directive, matches that in the UK Regulations. The argument below will consider this question in relation to the Scots law understanding of the Directive and UK Regulations, to confirm the argument made earlier that a TTFCA is a *fiducia cum creditore*.

The Collateral Directive was implemented in the United Kingdom by the Financial Collateral Arrangements Regulations (FCAR). The focus below is on Scots property law.

The UK Regulation, similar to the Directive, structures itself by contrasting between a TTFCA and an SFCA. The definition of these two arrangements is important to consider what amounts to a TTFCA under Scots law discussed below and English law in the next chapter. The Regulation defines a TTFCA as:

> An agreement or arrangement, including a repurchase agreement, evidenced in writing where a) the purpose of the agreement or arrangement is to secure or otherwise cover the relevant financial obligation owed to the collateral taker, b) the

> collateral provider transfers legal and beneficial ownership in the financial collateral to a collateral taker on terms that when the relevant financial obligations are discharged the collateral taker must transfer legal and beneficial ownership of equivalent financial collateral to the collateral provider.[692]

The Regulations further define an SFCA) as:

> An agreement or arrangement evidenced in writing where a) the purpose of the agreement or arrangement is to secure the relevant financial obligations owed to the collateral taker, b) the collateral provider creates or there arises a security interest in financial collateral to secure those obligations, c) the financial collateral is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral taker[….][693]

As seen above, the term 'security interest' appears in the definition of SFCA above. This term is further defined in the Regulations as:

> Any legal or equitable interest or any right in security, other than a title transfer financial collateral arrangement, created or otherwise arising by way of security, including a pledge, a mortgage, a fixed charge and a charge created as a floating charge. [694]

As will be argued in the next chapter, in English law, the consensus is that the distinction between the two types of arrangements reflects the distinction between an absolute interest (a TTFCA) and a security interest (SFCA).[695] An absolute interest is the residue interest out of which security rights are carved out. [696] In English law, this may be 'ownership' (legal or equitable) or possession. On the other hand, a limited right is vested in one 'who enjoys merely a specific right':[697] for example, a pledge, lien, mortgage (equitable) or a charge.[698]

The distinction between these two arrangements is uncontroversial in English law. However, as discussed in the next chapter, Beale notes, though briefly, that it is unclear whether a legal mortgage is indeed a TTFCA or an SFCA in relation to the Directive.[699] Indeed Akkermans falls into the trap of confusing a TTFCA as a legal mortgage in English law. According to him, a *fiducia cum creditore* is a TTFCA which is equivalent to a legal mortgage

[692] FCAR, Regulation 3.
[693] ibid.
[694] Ibid.
[695] Gullifer, 'Financial Collateral' (n 11) 384.
[696] McKendrick (n 305) 34.
[697] ibid.
[698] Beale and others (n 279) paras 4.04, 5.62.
[699] ibid 3.17.

in English law.[700] It is not difficult to identify why he holds that view: a legal mortgage, on the drafting of the Directive, fulfils the two conditions of applicability above. Therefore, the arrangement may supposedly be a TTFCA in the Directive. Nonetheless, it has been argued that this conclusion is contrary to the objective of the Directive, because the Directive applies to outright transfers.[701] However, as argued in the next chapter, although this may be accurate, there are reasons to agree with Akkermans based on the drafting in the Directive.

In relation to Scots law, which forms the focus of this section, the question is: how are the Regulations to be understood? First, the reference to legal and beneficial ownership may not apply to Scots law. Secondly, and more importantly, in Scots law the only way in which a TTFCA can be taken over financial collateral is by way of an assignation in security (*fiducia cum creditore).*[702] It has been suggested that this is a 'right in security'[703] which, if accepted, puts the transaction in the category of SFCA based on the definition in the UK Regulations. The issue below, then, is whether this position is accurate.

7.3.1 Scots law: use of ownership (*fiducia cum creditore*) as improper security

In the earlier discussion on the Directive, it was mentioned that the distinction between a TTFCA and an SFCA reflects the distinction in many Civil law systems between a *fiducia cum creditore* and *pignus*.[704] Scots law shares this distinction, although for financial collateral a *fiducia cum creditore* is the only security device available. However, in Scots law, the distinction between both types of arrangement generally matches the distinction between improper and proper securities. A *fiducia cum creditore* is an example of an improper security whereby 'a debtor transfers to a creditor ownership of assets as security for whatever claim the transferee might have against the transferor'.[705] There is a personal obligation on the transferee to reassign the property once the debt is discharged. [706]

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[700] Bram Akkermans, 'The European Union Development of European Property Law' (2011) 30 Maastricht European Private Law Institute Working Paper 1, 5 <available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1888294> accessed 30 October 2018.
[701] Beale and others (n 279) para 3.17.
[702] *Enviroco Ltd v Farstad Supply A/S* [2011] UKSC 16.
[703] Yeowart and others (n 252) 684.
[704] Erp and Akkermans (n 330) 505–518.
[705] ibid 505. In Scots law, an assignation may either be in security or may be made ex facie absolute. They both operate by way of transfer, and it is difficult to differentiate between them; see Alisdair MacPherson, 'Registration of Companies Charges Revisited: New and Familiar Problems' (2019) 23 Edin LR 154, 159.
[706] MacPherson argues that this requirement indicates the transaction is an assignation in security rather than *ex facie* absolute. MacPherson (n 705) 160.

In Scots law, it has been argued that a *fiducia cum creditore* is a right in security. Writing on this, Gretton argues that 'a right in security can be created either by a *fiducia cum creditore* or by *pignus* or *hypotheca'*.[707] This suggests that a *fiducia cum creditore* is a right in security. Similarly, Yeowart and Parsons also endorse this position. They note that although assignation takes effect by 'way of ownership transfer, such fixed securities are nevertheless considered "rights in security" ' in Scots law. [708]

It is simple to identify what influences these views. Yeowart and Parsons, in arriving at this conclusion, refer to the registration requirement in Part 25 of the Companies Act. They suggest that since an assignation is registrable under the Companies Act as a 'charge', it is therefore a right in security.[709] However, MacPherson offers an alternative approach which accommodates the opinion of Yeowart and Parsons and the contrary argument to be made below. According to MacPherson, the term 'charge', as used in the Companies Act, may be interpreted in two ways: first, in a broad way which extends the meaning of a right in security from its narrow meaning as a limited real right to include functional securities. In this sense, a *fiducia cum creditore* under the Companies Act 2006 regime is considered to be a right in security. MacPherson further notes that the term 'charge' may be interpreted narrowly in a way that stays true to the meaning of rights in security in Scots law as a limited real right.[710] In this second sense, MacPherson points out that the inclusion of an assignation in security as a 'charge' does not imply it is a security right, but may have been expressly included to bring it within the regime of charge registration.[711]

Essentially, MacPherson's first interpretation accommodates the views of Yeowart and Parsons because they define a *fiducia cum creditore* as a functional security because it is registerable. However, the second interpretation affirms the view below which treats the Scots law *fiducia cum creditore* as a transfer, rather than a security. As will be argued below, this second interpretation, unlike the first, aligns with the position in the Directive.

The point may be made that if Yeowart and Parsons, as well as MacPherson's first interpretation, are correct, the obvious conclusion will be that a *fiducia cum creditore*, based

[707] Gretton, 'Financial Collateral' (n 263) 213.
[708] Yeowart and others (n 252) 684.
[709] ibid.
[710] MacPherson (n 705) 159.
[711] ibid 159–161. MacPherson favours a broad meaning of security to include functional securities, such as sale and leaseback arrangements, retention of title arrangements. In his view, this gives a 'complete picture' in terms of publicity to those dealing with a company. This view contrasts with MacLeod's discussed in the next chapter.

on the definition in the Regulations, is a SFCA. This is because, in the Regulations, such an arrangement is synonymous with a security interest defined as including a right in security. However, within the context of the Directive, this position is questionable given that the position defines a *fiducia cum creditore* based on the registration requirement, rather than the actual rights created, i.e. ownership. In other words, similar to the approach adopted by Keijser above, Yeowart and Parsons define a *fiducia cum creditore* by the consequences of applicability (publicity rule) rather than the conditions of applicability (transfer of ownership). As already argued, both requirements do not conflate in identifying what amounts to a TTFCA in the Directive.

Gretton contradicts his positions above that a *fiducia cum creditore* is a right in security. He puts forward a different argument in an earlier article.[712] In the article he draws a distinction between security in the 'narrow or strict sense'[713] which is the 'true' security corresponding to a right in security,[714] and 'rights of retention'[715] which have similarities with a right in security, because the creditor has a right 'which he can avail himself of in the event of the failure of the debtor to meet his obligations'.[716] According to Gretton, a right in security in its narrow sense refers to a 'real right in the property of another person which secures the performance of an obligation'.[717] Expanding on this definition, Gretton argues that a right in security has certain characteristics: first, the collateral in question belongs to another person other than the creditor; secondly, the security exists only in relation to a secured obligation, that is, it is an accessory right which follows the debt; thirdly, when the right is realized, it produces money to fulfil a money obligation.

Importantly, a key factor for a right in security, according to Gretton, is that it creates a second (limited) real right in the asset, in addition to the real right of ownership which the debtor retains in the asset. This means that there are two real rights in the asset: the subordinate real right, and the right of ownership.

Although there are several requirements for a right in security, we will consider two: the first, which relates to the broader issue is, whether a transfer can be a security because it is for a security purpose? Secondly, does a *fiducia cum creditore* give rise to two real rights?

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[712] George Gretton, 'The Concept of Security' in Douglas J Cusine (ed), *A Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (W Green 1987) 126.
[713] ibid 127.
[714] ibid 130.
[715] ibid. The term 'retention' is used in a wide sense by Gretton to refer to arrangements under which ownership is retained or transferred.
[716] ibid.
[717] ibid 127.

7.3.1.1 Can a transfer be a security?

As Gretton admits, one feature which draws a *fiducia cum creditore* closer to a proper security is that it is made for the purpose of securing an obligation. [718] This importantly is what distinguishes it from a normal transfer and makes it susceptible to the risk of recharacterisation. However, this feature is equally what makes it an improper security.

However, it would be inaccurate to conclude that a *fiducia cum creditore* is a right in security simply because it performs a security function. In Scots law, the *ex facie* absolute disposition was a device which closely resembled the *fiducia cum creditore* .[719] Steven, writing on the accessoriness principle in relation to the *ex facie* absolute disposition, points out that the disposition was an exception to the accessoriness principle, because it was a transfer and not an arrangement which created a subordinate real right.[720] Steven concludes that the accessoriness principle had been 'removed altogether' from the *ex facie* disposition because it was a transfer rather than a security device.[721]

Although an *ex facie* absolute disposition was different from a *fiducia cum creditore*, it had the same 'patrimonial effect': it transferred title outright. [722] By analogy, it follows that since it was considered a transfer though it performed a security function, the same conclusion may be applied to a *fiducia cum creditore*. This implies that although a *fiducia cum creditore* performs a security function, it is simply a transfer and not a right in security which creates a limited real right in the collateral.

7.3.1.2 Only one real right in *fiducia cum creditore*

As mentioned above, Gretton further notes that a right in security creates a second limited real right in addition to the debtor's real right of ownership already in the asset. However, in a *fiducia cum creditore*, there is only one real right: the creditor's right of ownership. The debtor has purely a personal right. This personal right is the right to reacquire the asset on payment of the debt, and it is not accessory. From the creditor's perspective, the creditor's right of ownership in the collateral means that it can transfer the asset free from the debtor's right which is a right to retrocession.

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[718] ibid 130.
[719] Since 1970, an *ex facie* absolute disposition is no longer valid for security over land as a result of the Conveyancing and Feudal Reform (Scotland) Act, 1970.
[720] Andrew Steven, 'Accessoriness and Security Over Land' (2009) 13 Edin LR 387, 397.
[721] ibid.
[722] Ross Anderson and Jan Biemans, 'Reform of Assignation in Security: Lessons from the Netherlands' (2012) 16 Edin LR 24, 28.

Based on the above analysis, a *fiducia cum creditore,* in Scots law, is not a right in security (i.e. SFCA). It transfers ownership although it is made for a security purpose and is subject to the publicity rule. As also argued, it would be wrong to define the arrangement based simply on the publicity rule. Secondly, there is only one real right in the asset: i.e. the right of the collateral taker. This is unlike a right in security which creates an additional real right in the collateral over the debtor's real right of ownership.

The above discussion indicates that the approach in Scots law in relation to *fiducia cum creditore* is similar to the Directive's approach to a TTFCA, i.e. once ownership is transferred for a security purpose, the transaction is effective as a transfer. This interpretation will accord with the conditions of applicability in the Directive for identifying a TTFCA. As discussed above, the key consideration in identifying what amounts to a *fiducia cum creditore* is whether it transfers ownership, and whether it is for a security purpose. A *fiducia cum creditore* in Scots law satisfies these two conditions. *Contra* Keijser and Yeowart and Parsons above, it would be inappropriate to identify the transaction based on the publicity requirements or on other restrictions which a system may impose on it.

A secondary question arises whether anything in Scots law therefore qualifies as an SFCA. Currently, nothing in Scots law qualifies as such for financial collateral. However, the Scottish Law Commission has prepared a Report which proposes such a device.[723] A proposal is made in the report for a fixed security (i.e. a 'statutory pledge') which may be created over shares and incorporeal movables other than receivables and money claims.

Lastly, in the Regulations, as noted, a TTFCA is defined as the transfer of 'legal and beneficial ownership'. Apparently, these terms reflect the interests in English law. In Scots law, as seen in section 5.3.1, ownership is unitary. However, for the purpose of giving effect to the Regulations, the terms may functionally be interpreted as referring to all rights and interests in collateral. This way they appropriately capture an assignation in security in Scots law under which the full entitlement is transferred.[724]

7.3.2 *Fiducia cum creditore* as TTFCA in Directive

The argument above is that a TTFCA, in the Directive, is an improper security (e.g. *fiducia cum creditore*). As noted, different legal systems respond to it in different ways.

[723] The device will be called a 'Statutory Pledge'; see Scottish Law Commission, *Report on Movable Transactions* (Scot Law Comm No 249, 2017) volume 2, Chapters 19-22.
[724] This provides a support for the definition in the Regulations. As demonstrated in the next chapter, the definition also provides solution to the problem of a legal mortgage.

In some systems, the rules on publicity are applied to a *fiducia cum creditore*, as is the case in Scots law. In other legal systems, such as Dutch law, the *fiducia cum creditore* is prohibited. However, the Collateral Directive mandates Member States to recognise a *fiducia cum creditore* so that its terms take effect.

In defining a TTFCA, the Directive use words such as 'securing' to refer to the effect of the transaction. Yeowart and Parsons argue that this term is not to be given 'a technical meaning' but refers to any arrangement whereby financial collateral is provided to reduce the exposure of the collateral taker. [725] This argument is questionable. It still shows that the primary purpose for such a collateral transaction is to reduce any losses in the event of default of a counterparty – this is a security purpose. However, the effect of such a transaction may only matter in identifying the transaction. It does not matter regarding the consequences to be placed on the transactions: the Directive only considers the rights and obligations in imposing consequences.

This matters because it is ironic that the Directive adopts a formal, rather than functional approach, in the way it characterises transactions. This contrasts broadly with the functional method behind how directives, as legislative instruments, operate. Moreover, it re-echoes the argument in chapter two, that the functional method is inherently pragmatic; it sets its sight to achieve specific ends with different conceptual tools.

7.4 CONCLUSION

As noted, a TTFCA under Scots law operates by way of a *fiducia cum creditore*. This is a secured transaction. Although a *fiducia cum creditore* is entered for a security purpose, the transaction is broadly recognised as a matter of 'common law' in Scotland and given effect.[726] Therefore, there seem to be few restrictions placed on the rights of the collateral taker,[727] even though it is generally acknowledged in Scots law that the transaction is an 'improper security' and may well exceed what the parties want.[728] Thus, Scots law, like the Directive, treats such a transaction as a security arrangement, but gives it effect as a transfer of ownership in line with the Directive. The publicity requirement in Part 25 imposed on such transactions, which are imposed because the transaction performs a security function, is not a condition of applicability in the Directive. On the contrary, the requirement is disapplied by the Directive once the transaction is

[725] Yeowart and others (n 252) 153.
[726] Scottish Law Commission, *Discussion Paper on Movable Transactions*, 44.
[727] Except maybe the registration requirement under Companies Act, 2006, part 25.
[728] Scottish Law Commission, *Report Paper on Movable Transactions*, para 17.16.

identified as satisfying the two conditions of applicability already mentioned. In the next chapter, we will consider the application of these conditions of applicability in English law and the possible effects, or tensions, that may arise in particular relation to a legal mortgage.

8 CHAPTER EIGHT: TTFCA AS A LEGAL MORTGAGE?

8.1 ENGLISH LAW: INTRODUCTION

The previous chapter identified what amounts to a TTFCA and the conditions of applicability which are used to identify the arrangement. It was argued that applying those conditions of applicability, a TTFCA is a *fiducia cum creditore* in Civil law, particularly in Scots and Dutch law.

This chapter considers the issues under English law regarding whether the TTFCA in the UK Regulations is similar to that in the Directive based on those same conditions of applicability. In this regard, the arguments in this chapter are: first, functionally applying those conditions of applicability in English law, there is the potential risk of defining a TTFCA as a legal mortgage. This is because a legal mortgage in English law can similarly be defined based on those conditions of applicability as: a)a transfer of ownership b) for a security purpose. This raises a potential risk that it may be 're-characterised' as a TTFCA based on the provisions of the Directive. However, as argued below, to avoid these unintended consequences, an insider/contextual approach needs to be adopted, as opposed to an observer/functional perspective regarding the legal mortgage.[729] This requires an evaluation of an TTFCA using English law doctrinal principles, particularly the equity of redemption, to circumvent the unintended consequences in the Directive. Thus, this suggests that a) the provisions of the Directive are not system-neutral and cannot be understood simply in terms of the specific effects or conditions of applicability, but must be seen within the doctrinal context of English law; b) secondly, and relatedly, that it may be difficult to reconstruct an institution into specific functional effects (i.e. conditions of applicability), as done by the Directive.

To demonstrate the above points, the chapter will focus on how the definition of a TTFCA in the UK Implementing Regulations circumvents the above risk in relation to a legal mortgage. As highlighted in section 7.3, a TTFCA is defined in the UK regulations as the transfer of legal and beneficial ownership. It has been argued that this definition does not correctly capture an intermediary's right in intermediated securities: what an intermediary has is beneficial ownership, not legal and beneficial ownership. In addition to this, it will be argued that the definition equally does not capture the right of a collateral provider in registered shares.

[729] Samuel notes that an insider/internal perspective is one which attempts to understand a concept from the perspective of the 'participants': for example, an English lawyer attempting to understand a concept of English law. On the other hand, an outsider/external perspective involves a foreigner attempting to understand a foreign concept: for example, a French lawyer attempting to understand an English law concept. See Samuel (n 65) 61–62.

However, the argument will be made below that although this definition is inappropriate for intermediated securities and registered shares, it appropriately addresses the risk that a legal mortgage may be seen as a TTFCA in the Directive.

To elaborate these points, the chapter is divided into four sections: the first considers the relationship between legal ownership and beneficial ownership. This is considered because, as discussed below, the relationship between these interests determines the conclusions reached in the context of a legal mortgage, registered securities and the intermediary's right in intermediated securities, respectively. The second section considers how that relationship plays out in each of those situations. The third section considers how each of the interests in those situations (i.e. equity of redemption, legal ownership, and beneficial ownership) are categorised as absolute interests in English law. The fourth concludes the chapter.

It is important to note that the chapter considers the meaning of a TTFCA in the Directive from the internal perspective of English law. In discussing this issue from the perspective of English law, the purpose is not to examine if the Directive has been properly implemented, but only to demonstrate how the functional definition of a TTFCA in the Directive can only be understood within a doctrinal context.

8.1.1 Are both legal *and* beneficial ownership required for full ownership?

As noted above, there is the need to identify the relationship between legal and beneficial ownership, as the issue runs through the question addressed in this chapter: that is, what is the nature of the equity of redemption in relation to the right of a legal owner in a legal mortgage? Secondly, what is the nature of a right of a legal owner and a beneficial owner in registered securities and intermediated securities?

An argument might be made that where a party has the legal title to an asset, without any beneficial ownership, he may be deemed to have full ownership. This implies that in the absence of any other party having an equitable interest in the collateral, the party has full ownership. However, this view cannot be extended to beneficial ownership, since the idea of beneficial ownership is premised on the idea of a divided ownership, as discussed in chapter five.

Some endorsement of this view may be found with Goode who argues that: 'if both legal and beneficial ownership are vested in the same person, there is no scope for equity to

operate on the asset, and no separate equitable interest can be said to exist'.[730] Likewise, in *Commissioner of Stamp Duties* v *Livingston,*[731] the court arrived at a similar conclusion. In that case, a testator, by his will, granted his estate to his executors and trustees, one of whom was his widow. The widow subsequently died intestate during administration of the estate before any final distribution. The Commissioner of Stamp Duties brought a claim against the administrators of the estate of the widow for succession duty in respect of the widow's share of the asset of the testator. The House of Lords held that at the time of the widow's death, the administration of the testator's assets had not been completed. Therefore, at that point she could not have any beneficial interest in the asset. The administrator, according to Viscount Radcliffe, had '*full ownership*, without distinction between legal and equitable interest. The whole property was his'.[732]

This suggests that once there is no separate equitable title in the asset, a party has full title. As discussed later in this chapter, Gullifer, writing on intermediated securities, suggests that the alternative interpretation to the definition in the Regulations should be 'full ownership or full beneficial ownership'. The first expression (full ownership) may have been proffered with the above decision in mind. However, her second suggestion indicates that there can indeed be 'full ownership' on the one hand, and on the other hand, ownership which is not full. Therefore, while the first complies with the Directive, the other does not.

As mentioned already, the idea of equitable ownership is premised on divided ownership. The converse is that in the absence of beneficial ownership, a party with only a legal title may be said to have full ownership: while divided ownership is the essence of an equitable title,[733] a party with only a legal title has full ownership. Does this mean that legal ownership is the primary and residual right, while equitable ownership is merely subordinate, since it is dependent on the legal title?

As noted in chapter five, the trust is a classic example [734] of divided ownership in English law and as such it is a good reference point to determine the nature of the relationship between these two rights.[735] In a trust, while legal title is vested in the trustee, the beneficiary has beneficial title. Importantly, the beneficiary's right is considered to be 'parasitic' to the

[730] McKendrick (n 305) 42.
[731] [1965] AC 694.
[732] ibid 707.
[733] McKendrick (n 305) 42.
[734] ibid. As will be seen below, division of ownership may also occur without a trust relationship, namely when A holds the legal title primarily for his own interest, as in the case of a mortgage.
[735] William Swadling, 'Trusts and Ownership: A Common Law Perspective' (2016) 24 ERPL 951, 966. Swadling argues that there are trusts without beneficiaries, for example, in the case of the public trust.

trustee's right. This suggests that the legal title is the primary right, while the beneficiary's right is subordinate. Thus, that the beneficiary's interest is parasitic or derivative suggests that there is another party with a legal title out of which the beneficial interest is 'carved out'. It implies that the legal title is the primary title.

Goode seems to endorse this view. He points out that 'though an equitable interest can be *carved out* of the legal title, the converse is not true'.[736] In essence, while it is possible to derive an equitable title from a legal title, it is not possible to derive a legal title from an equitable title; we can only derive another equitable title from an earlier equitable title. This suggests that a legal title enjoys some primacy as the dominant right out of which an equitable right is created. This will be equivalent to what happens in a security arrangement where a party with ownership creates other limited rights from his interest. In this sense, the owner's right is residual. However, the second view below, of Swadling, essentially disagrees with this.

8.1.2 Beneficial rights as 'engrafted' right

According to Swadling, it is wrong to state that a trust splits ownership between a trustee and a beneficiary.[737] To maintain this view, according to Swadling, he suggests that the trustees had rights in the property which were then split into two after the trust was created. However, Swadling argues that the trustee is the 'owner' of the rights with respect to the thing, since the rights in the property are vested in him. He points out that both prior to, and after the trust is declared, the total number of rights in the trustee remain the same. In his view, this only suggests that the beneficiary's right, rather than having been carved out of the trustee's right, is only engrafted on it. The beneficiary's right is a new right. It does not arise from the splitting of pre-existing rights.[738] Essentially, the beneficiary's right, in Swadling's view, is a right to compel the trustee to use his right in a particular way. It is a personal right against the trustee and therefore cannot be carved out.

In considering why, during insolvency, the trust assets are removed from the trustee's estate, Swadling argues that the trustee's right does not receive insolvency protection because of a 'statutory regime and the legislature has exempted rights held on trusts from being available to satisfy the debts of an insolvent trustee'. [739] Essentially, Swadling argues that the trustee's right does not receive protection because it is a legislative choice. This statement focuses on the trustee's right, but has implications for the beneficiary's right: in relation to the beneficiary, it

[736] McKendrick (n 305) 43. (Emphasis mine).
[737] Swadling, 'Trust and Ownership' (n 735) 951.
[738] ibid 970.
[739] ibid 971.

equally suggests that that the insolvency protection of beneficial interest is based on a legislative choice.

Swadling's statement suggests that prior to the statutory protection, the beneficiary's right was not protected. However, as seen in chapter five, Lau points out that historically the Chancery Court started off protecting the beneficiary's right against the trustee alone, but subsequently extended the protection to third parties.[740] The protection afforded the beneficiary therefore is not just based on legislative interventions, as Swadling suggests, but on the remedies historically developed by the Chancery to protect beneficiaries.

Secondly, Swadling seems to focus exclusively on the legislative act/Act itself, rather than on the reasons behind the act/Act. Although it may be a legislative choice to remove the trust assets from the estate of the trustee, this can only be based on the fact that the beneficiary has a property right. Why protect an asset where there is no property right?

> Importantly, Swadling's view above privileges the legal owner as having the primary right in the asset. As earlier noted, he argues that the trustee is the 'owner' of the rights, since the rights in the assets are vested in him. On the other hand, the beneficiary's right, as seen above, is a personal right. If this is the case, it means that the legal title holder, since he has title to the asset, may be said to have 'ownership' of the asset. [741] The beneficiary's right is not carved out, neither is it an ownership right. It is merely a right vested in the beneficiary to compel the trustee to use his rights in a particular way.[742] It is a personal right.

There is some similarity between both Swadling and Goode: they both acknowledge the primacy of legal title. However, while Goode accepts that beneficial interest is carved out of legal title and is a real right (and an ownership right in the sense of English law), Swadling rejects the idea that beneficial interest is carved out of the legal interest. He also rejects any notion of beneficial interest as 'ownership' and appears to accept that the legal title holder 'owns' the asset because it has the direct rights to the asset. Like Goode, Swadling gives preference to the legal title holder.

As earlier stated, the UK Regulations define a TTFCA as an arrangement under which legal and beneficial ownership is transferred. Swadling's analysis above therefore renders this definition questionable. First, the term 'ownership' may strictly not refer to any concept in

[740] Lau (n 408) 7.
[741] Swadling, 'Trust and Ownership' (n 735) 971. Swadling uses similar words, though in inverted commas to describe the trustee's right.
[742] ibid 970.

English law, based on Swadling's analysis. At the level of the Directive, Swadling may reject the claim that anything in English law qualifies as full ownership, since English law has no such concept. However, in line with Swadling's analysis, the functional equivalents will be legal title[743] or the beneficiary (personal) right. Importantly, Swadling may reject that legal and beneficial ownership can be vested in the same person. (i.e. collateral provider). However, as earlier mentioned, the beneficiary's right is a personal right to compel the legal title holder. This means that the right is vested in another party other than the legal title holder: a person cannot have a personal right against herself to act in a certain way. In essence, the nature of a right or a personal right is that it imposes a corresponding duty on another, who in this case is the legal title holder, to perform an obligation or to refrain from carrying out certain actions. Therefore, both legal title and beneficial personal right, based on Swadling's analysis, necessarily are vested in different persons. Consequently, since a party cannot have both legal title and beneficial right in the asset, there can only be a transfer of either legal title or beneficial (personal) rights, not legal and beneficial ownership.

Swadling's analysis further suggests that in a TTFCA involving beneficial rights, what is transferred is the personal right against the trustee.[744] This is not a right in the securities, but a right against the trustee to use the securities for the benefit of the beneficiary. In intermediated securities, seen below, Swadling's analysis suggests that at the lower tier intermediaries, the beneficiaries only transfer personal rights. This position is similar to the position in Scots law, seen in section 5.3.2. Swadling, like Scots law, therefore, rejects any idea of division of ownership rights in a trust. However, while under Scots law, the trustee is vested with ownership, in Swadling's case the trustee is vested with legal title, which functionally is unitary 'ownership', since the beneficiary has only personal rights in the collateral. In both Scots law and Swadling's analysis, the financial collateral dealt with is the personal rights against the trustee.

However, the language of the Regulations presuppose that Swadling is wrong. The Regulations indeed endorse the view that there can be legal and beneficial ownership in financial collateral. In taking this position, the Regulations support Goode's view, which is the conventional one in English law. Thus, a party may have legal ownership out of which is carved

[743] It is debateable if Swadling would use the term 'title' in reference to securities which are choses in action and cannot be possessed. Swadling seems to restrict the term 'title' to title to possess, which may only apply to tangible assets: William Swadling, 'Rescission, Property and the Common Law' (2005) 121 LQR 124, 135; Swadling, 'Ignorance and Unjust Enrichment' (n 346) 640–641.

[744] Swadling, 'Trust and Ownership' (n 735) 980. Swadling points out that the beneficiary's right is assignable.

beneficial ownership. The Regulations will also seem to endorse that beneficial ownership is a proprietary right based on the drafting. On this note, the Regulations may be criticised as taking sides in an ongoing academic debate on the nature of beneficial interests.[745] It imposes a theory in place of other alternative theories that offer equally good explanations about the nature of equitable interests.

We will consider below how two distinct approaches are taken in English law in relation to legal ownership. Although the above suggests legal ownership is the dominant, residual right, it does not operate as such in all situations. From the discussion below, a legal mortgage transfers legal ownership. However, the equity of redemption (an equitable right) is said to be a 'residual right' which trumps the legal ownership. The converse, however, appears to be the case in a transfer of registered and intermediated securities.

8.1.3 English law: TTFCA and legal mortgage as the transfer of ownership

As previously stated, a TTFCA in the Directive is defined as an arrangement under which the collateral provider transfers full ownership of financial collateral to the collateral taker for the purpose of securing an obligation. This definition, as argued below, is not different from how a legal mortgage operates in English law.

Historically, interest loans were prohibited in England.[746] To circumvent this prohibition, parties executed a legal mortgage which was a loan disguised as a sale of land with a reversionary right. The borrower conveyed the property in fee simple in consideration of a sum. The lender, by the agreement, agreed to reconvey the property once the sum had been repaid. The agreement operated as an outright transfer, with the lender becoming the absolute owner. It had several disadvantages. The lender could refuse to reconvey the property leaving the borrower with minimal protection under the common law. The borrower also forfeited the property even where he was in default by a single day. Because of the scant protection offered under the common law, equity intervened to mandate the lender to reconvey the property. Equity imposed an obligation on the lender which could not be contracted out of. In arriving at this result, equity can be said to have taken a 'functional approach': it focused on the purpose of the transaction, bypassing the fact that it was a transfer. It took the transaction as effectively creating a security right, with the borrower retaining a right in the asset.

[745] Gretton, 'Ownership and Its Objects' (n 307) 804.
[746] Leonard Jones, *A Treatise on the Law of Mortgages of Real Property*, vol 1 (6th edn, 1904) 178.

This historical development has contributed to how a legal mortgage is defined. In English law, several definitions have been offered for a legal mortgage. Benjamin defines it as the transfer of 'full legal and equitable title (subject only to the equity of redemption)'.[747] It has also been defined as the transfer of ownership in collateral subject to a right of redemption.[748] Goode similarly defines it as a 'transfer of ownership of the asset […] by way of security upon the express or implied condition that ownership will be re-transferred to the debtor on discharge of his obligation.[749]

Both Beale and Goode simply refer to ownership, while Benjamin refers to 'full legal and equitable title'. It is unclear whether by 'ownership' Beale and Goode refer to the transfer of full interest (both legal and beneficial) in the collateral, or rather the legal ownership. Benjamin's definition suggests that what is transferred is both the legal and beneficial ownership. However, the collateral provider, as Benjamin states, retains the 'equity of redemption'.

The question arises as to the nature of the equity of redemption: is it synonymous with beneficial ownership or does it refer to an equitable right to ask for a re-transfer of the collateral? The security nature of the transaction implies that the equity of redemption is a 'right of ownership', as discussed below. A person retains his ownership eight even after a security right is granted. As discussed below, this thinking is likely behind the authors which treat the equity of redemption as a residual right.

The definitions of a TTFCA in the Directive and a legal mortgage have a close resemblance, especially if it is taken, as Benjamin does, that a legal mortgage transfers full legal and equitable title. As earlier mentioned, where a party has both legal and beneficial ownership, he has full ownership. Additionally, both a TTFCA and a legal mortgage operate by way of a transfer, and both are made for the purpose of securing a relevant obligation. Given this similarity, there is a potential risk that a legal mortgage could be seen as a TTFCA in the Directive. Akkermans' indeed falls into this trap. According to him, a *fiducia cum creditore* is a TTFCA which under English law is equivalent to a legal mortgage. Thus, he suggests that a TTFCA is a legal mortgage in English law.[750] The implication of this is that the consequences provided in the Directive apply to such transactions. For example, the rules which will apply once a TTFCA is identified may apply to a legal mortgage with the effect that the legal

[747] Benjamin (n 258) para 5.07.
[748] Beale and others (n 279) para 6.01; Beale refers to *Santley v Wilde* (1899) 2 Ch 474 (CA).
[749] Gullifer, *Goode and Gullifer* (n 275) para 1.54; McKendrick (n 305) 632.
[750] Akkermans, 'EU Dev of Property Law' (n 700) 5.

mortgage might be given effect as it is (i.e. be seen as a transfer). Additionally, the rules normally applicable to such security devices, e.g. publicity rules, may be disapplied. If these consequences were to arise, it may be argued that the legal mortgage may cease to be a security device in English law, since it is given effect as it is (a transfer). It is therefore recharacterised as a TTFCA since it fulfils the conditions of applicability for such transactions under the Directive.

Comparatively, it may be said that the features of a *fiducia cum creditore* are similar to a legal mortgage. Therefore, both institutions are functionally equivalent. In both arrangements ownership is transferred and for a security purpose. As such, if the Directive applies to a *fiducia cum creditore*, why should it not equally apply to a legal mortgage? In this respect, it is important to note that the response to the *fiducia cum creditore* in the pre-1992 Dutch law, as earlier discussed, was almost the same with the sceptical response of English law (equity) to the legal mortgage. In both systems, there were attempts to apply, by analogy, rules applicable to proper securities to such purported transfers. Although this historical response in both systems is less important here, it reveals similar scepticism under both Dutch law and English law to arrangements which operate as a transfer but have a security purpose. The similarity in the characteristics of both transactions, coupled with the scepticism in both systems against such purported transfers, indicate that the transactions are in fact similar and thus the institutions are equivalent. Therefore, if a *fiducia cum creditore* in Dutch law is recognised as it is regardless of the historical scepticism, why should not the same rule be extended to the legal mortgage which, like the *fiducia cum creditore*, is a transfer, though with restrictions imposed by equity?

The potential risks discussed above shows a gap in the logic of the Directive. On the one hand, the Directive assumes that recharacterisation is something the parties never desire — it is an external event. This thinking informs the provisions of the Directive that Member States are to recognise TTFCAs as they are, that is, not to impose a term contrary to that desired by the parties, but to give effect to their agreement. However, in the case of a legal mortgage, it may be said that what effectively happens is that a transaction which is a transfer is subsequently recharacterised as a security device. This functionally is recharacterisation, although it is anticipated by the parties. Thus, the law recognises the transaction as a security device on the assumption that the parties intended to create such a device by transferring ownership.

8.1.3.1 Is the equity of redemption beneficial ownership?

As earlier stated, a TTFCA is defined in the Regulations as an arrangement under which a collateral provider transfers legal and beneficial ownership in collateral to the collateral taker.

Pursuant to the Regulations, for there to be a TTFCA both legal and beneficial ownership need be transferred. This provision may be interpreted in two ways. The first interpretation is based on Benjamin's definition above. As seen above, Benjamin defines a legal mortgage as the transfer of 'full legal and equitable title' (i.e. legal and beneficial ownership) subject to the equity of redemption. If this definition is accepted, it means that the Regulations do not in fact provide a solution to the problem above. Similar to the definition in the Regulations, a legal mortgage also transfers full legal and equitable title, which is full ownership. This therefore puts a legal mortgage within the scope of the definition of a TTFCA in both the Directive and the Regulations.

A likely objection may be that in a legal mortgage, the transfer is made subject to the equity of redemption. However, this objection may not matter. Where an owner creates a security right, it is normal to still refer to the person as having the ownership right. Similarly, based on the drafting of the Regulations, we may nonetheless refer to a legal mortgagee as having the 'legal and beneficial ownership', even though the equity of redemption remains in the collateral provider.

Regardless of the transfer in a legal mortgage, the collateral provider retains the equity of redemption in the collateral. This right will normally trump the legal and beneficial ownership right of the collateral taker in the asset. Because of this, the question arises as to the nature of the equity of redemption: is it an ownership right or simply a subordinate real right? The answer to this question, as seen below, links back to our earlier discussion of the relationship between legal and beneficial ownership.

The nature of the equity of redemption is not 'entirely clear'.[751] Beale *et al* point out that although it is clearly a proprietary interest in an asset, it may mean different things. According to Beale, the equity of redemption may refer to the security giver's residual interest in the asset after the security holder's right is 'carved out'. It may also refer to an equitable right to redeem or recover the property.

[751] Beale and others (n 279) para 6.02.

In Civil law [752] and even in Common law [753] it is normal to define ownership as a residual right out of which lesser rights may be carved out. It is a residual right in that it refers to the 'legal rights remaining in a person, or in persons concurrently, after specific rights over the asset has been granted to others'.[754] Such rights which may be 'carved out' are myriad, but they include security rights. In a security transaction, ownership is retained by the security giver, who may burden the property by granting a limited right. In this sense the ownership right of the security giver is described as a residual right, i.e. what is remaining after the limited real right is created.

The equity of redemption is described in similar terms by Beale *et al* as a residual right. This suggests that it is an ownership right which is then 'burdened' by the legal ownership transferred to the collateral taker. The equity of redemption is enforceable against successors who unlawfully purchase the asset and thus has a proprietary effect. This may indicate that it is indeed a real right and may be referred to as 'beneficial ownership' which the collateral provider retains.[755]

Swadling may reject the above analysis. Based on his analysis, seen earlier, equitable interests are personal rights. Therefore, the equity of redemption, which is an equitable right, qualifies as a personal right in the mortgagor after the property is transferred. The mortgagor by this personal right can personally mandate the mortgagee to reconvey the property once the obligation is discharged.

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[752] Gretton, 'Ownership and Its Objects' (n 307) 834. Gretton suggests that residuarity is not an exclusive feature of ownership, since primary personal rights are residual.
[753] Honoré (n 18) 126; McKendrick (n 305) 34.
[754] McKendrick (n 305) 34.
[755] The existence of two real rights in a legal mortgage draws the arrangement closer to a 'trust': the mortgagee has legal ownership, while the mortgagor has an equitable interest. The mortgagee, like a trustee, is under an obligation in favour of the mortgagor, or beneficiary, in relation to the asset. He cannot dispose of them free from the trust. Regardless of this similarity, the content of the obligation is different in both transactions. On the one hand, a legal mortgagee takes the asset for its own benefit. Where the debtor fails to perform his obligation, the mortgagee may sell the property and keep the proceeds. This essentially indicates that the rights in the property are for his own benefit. On the other hand, in a trust, a trustee is normally under a duty to use the asset for the benefit of a beneficiary, and where the assets are unlawfully sold, the beneficiary may claim the proceeds. This close resemblance of a trust to a mortgage potentially makes it risky to use a trust as a TTFCA. A TTFCA gives rise to an absolute interest. However, where a collateral provider transfers the collateral on trust for the collateral taker, there is the risk that the arrangement may be seen as a security interest. First, the beneficiary still retains some interest in the collateral, and secondly, this may be treated as a security transaction for recourse purpose. This arose in *Gray v GTP Group Ltd , Re F2G Realisation (Ltd) (In Liquidation)* [2010] EWHC 1772 (Ch) discussed in chapter ten; see Gullifer, *Goode and Gullifer* (n 275) para 6.38 who note that in a TTFCA the collateral taker must not hold the collateral on trust for the collateral taker.

Because a legal mortgage is a transfer and not a trust, a legal mortgage, based on Swadling's analysis, will operate as a full transfer of legal title. The collateral provider, as already mentioned, only retains a personal right in the collateral. This analysis, which is based on Swadling's position, draws the legal mortgage closer to a TTFCA. It does not help to resolve the potential trap already mentioned.

However, one problem with Swadling's analysis,[756] within the context of a legal mortgage, is that it does not provide any answer why the equity of redemption trumps the legal ownership. As a personal right, the mortgagor's right ought not to be enforceable against third party successors.[757] However, this is generally not the case. As seen below, the answer to this may be that the legal mortgage is one example where an equitable right trumps a legal right.

As discussed earlier, legal ownership is treated as the primary right. However, the nature of the equity of redemption in a legal mortgage appears contrary to this. The court will normally mandate the legal mortgagee to return the asset once the debt is paid.[758] This suggests that the legal mortgage may be one of the exceptions to the primacy of legal ownership.

On a practical note, English law treats the legal mortgage as creating a limited interest (SFCA), as opposed to an absolute or outright interest (TTFCA). [759] The reason for this is that the right of the collateral taker is not outright; it is burdened by the equity of redemption. As noted, the equity of redemption is enforceable as a property right against the mortgagee and his successors.

In arriving at the above result, English law (equity), as already noted, historically took a 'functional approach'. It focused on the purpose of the transaction bypassing the fact that it was a transfer. It is for this reason that the equitable right becomes the primary and residual right, which trumps the legal ownership. Equity functionally converted the legal ownership into the lesser right. It took the transaction as effectively creating a limited interest and therefore 'recharacterised' it as a security device, without having regard to the transfer. Thus, having recharacterised it as a security device, the rules applicable to security arrangements were applied to it.

[756] This is a broader issue for Swadling regarding the third-party effects of beneficial rights.
[757] Although as seen in chapter five, the idea that a right may have third-party effects does not mean it is a real right.
[758] *Kreglinger v New Patagonia Meat & Cold Storage Company Ltd* [1914] AC 25; *Johnson v Diprose [1893] 1 QB 512* (1893) 1 QB 512.
[759] Swadling, 'Trust and Ownership' (n 735) 953. Another name for an absolute interest is outright interest.

This ‘functional approach’ adopted by equity to a legal mortgage counters the approach of the Directive. As earlier noted, the Directive adopts a functional approach to identify a TTFCA and then a formal approach to give effect to the rights created. On the other hand, equity adopts a functional approach to identify the transaction as well as to apply consequences of security rules. Thus, in equity, because the purpose of the transaction was to create a security right, the transaction was to take effect as such regardless of the transfer.

On the one hand, the outcome reached under equity runs counter to the provisions of the Directive. Based on the arguments made in relation to the Directive, although a legal mortgage is a transfer for a security purpose, it ought to be given effect without treating it as a security device. However, the above outcome is not what is desired either under the Directive or English law. The Directive cannot impose an impossible requirement on English law not to recognise the legal mortgage, since the purpose of such an institution is that the device is to be used as a security device. The above may indicate that there are indeed doctrinal presuppositions in the Directive. The functional definition in the Directive only makes sense within the context of these doctrinal principles.

In summary, the discussion above shows that the drafting of the Regulations may, or may not, provide a solution to the conceptual trap in the Directive. Because the equity of redemption has a different meaning, it is problematic to arrive at any firm conclusions. However, as already discussed in chapter one, the functional theory emphasises results. In this regard, Beale *et al’s* argument highlighted earlier provides an acceptable result. Beale *et al*, as noted, define the equity of redemption as a residual right. This suggests that it is an ownership right and implies that the definition in the Regulations indeed provides a solution to the potential difficulty above. As noted, a TTFCA is defined as an arrangement under which legal and beneficial ownership is transferred. Therefore, where the collateral provider transfers only legal ownership, but retains the beneficial ownership in the asset, this suggests that the transaction is a legal mortgage. For this not to arise, the collateral provider must transfer ‘legal and beneficial ownership’, as provided by the Regulations, or rather he must transfer the right in the collateral outright. The definition in the Regulations therefore provides a solution to the conceptual trap.

The above conclusion implies that the effects reached under English law in relation to a legal mortgage is functionally the same as that under a *fiducia cum creditore*. Although both institutions are transfers, they are defined as TTFCAs depending on whether or not the interest was transferred outright. While on the one hand, a legal mortgage is not an outright transfer and thus not a TTFCA, a *fiducia cum creditore* is an outright transfer and as such is a TTFCA.

As will further be argued below, although the definition in the UK Regulations provides solution to that problem, the definition, according to some authors, is inappropriate within some contexts.

8.2 SECURITIES AND TTFCA: INTRODUCTION

As earlier noted, the definition of a TTFCA in the Regulations also causes problems for TTFCAs in respect of intermediated securities and registered securities under English law. Registered securities deal only with legal title. Thus, a TTFCA involving such securities necessarily entails the transfer of legal title. For intermediated securities, the lower tier intermediaries have only beneficial ownership and thus only beneficial ownership is transferable in a TTFCA at the lower tier. However, to understand why these issues arise, it is important to consider the meaning of financial collateral under English law.

Before we proceed it is important to note that both legal title and beneficial ownership qualify, in a functional sense, as 'full ownership' under English law (that is, if we are to use insolvency, or third-party effects, as a test for what amounts to full ownership). For instance, between the trustee and an insolvent third party in custody of the asset, the trustee's legal title is protected. [760] Also, between the trustee and the beneficiary, the beneficiary's right is protected in the insolvency of the trustee.[761] Therefore, both interests may be deemed to be full ownership to the extent that they achieve third-party effects.

8.2.1 Financial Collateral as Choses in Action

The Regulations only apply to dealings with financial collateral. Therefore, we need to know what these things are under English law. As will be seen below, the distinction between legal choses in action and equitable choses in action partly explains why a TTFCA dealing with registered securities transfers only legal ownership, while a TTFCA dealing with intermediated securities transfers equitable ownership.

As discussed in section 4.3.1, financial collateral in the Regulations refers to cash, credit claims and financial instruments. English law characterises these objects as choses in action. A chose is action 'comprises interests in all personal chattels that are not in possession'.[762] It describes all personal rights in property which can only be claimed by way of an action rather than by possession.[763] In section 5.2.1, it was noted that the classification of interests in English

[760] Eva Micheler, *Property in Securities: A Comparative Study* (Cambridge University Press 2007) 31.
[761] Section 283 (3) (a) Insolvency Act 1986. The section applies to individuals, but applies by analogy to companies. Swadling, 'Property: General Principles' (n 453) para 4.152.
[762] Smith and Leslie (n 310) para 2.52.
[763] ibid.

law derives from the procedure by which an interest in things were enforced. Thus, a chose in action, as opposed to a chose in possession, denotes things which are enforceable by way of action, rather than by recovery through possession.

It is controversial whether a document, such as a negotiable instrument, which embodies the right, is a chose in action or a chose in possession. On the one hand, the document embodies rights which will be regarded as choses. On the other hand, the rights are 'locked up in the document' [764] so that the rights may be enforceable by physical possession of the document. The 'predominant view'[765] is that such documents are choses in action, but English law by a 'legal fiction' applies rules, such as the rules on conversion,[766] which apply to choses in possession, to such documents.[767]

It is important to note that a chose in action may give rise to a right to bring an action either under the common law or equity. According to Smith and Leslie, a common law chose in action is a chose which before the Judicature Act 1873 could be enforceable under the common law. [768] This include such items as a debt and registered shares.[769] On the other hand, equitable choses in action were those for which an action could be brought in the court of equity[770]: for example, rights claimed by the beneficiary under a trust.[771] This distinction is seen likewise especially in the case of registered securities which deals with legal ownership.

In summary, it may be said that cash, credit claims, and financial instruments are all legal choses in action. Cash gives rise to a repayment obligation, so also for credit claims which are debt under the common law. For registered shares, it is said that it is difficult to determine when the common law started regarding them as a legal chose in action.[772] Nonetheless, they are legal choses in action and legal title in them is regulated by the Companies Act 2006. As discussed below, the registration of shares confers on the holder a legal title. However, a party may have an equitable interest especially in cases where there has been an uncompleted transfer

[764] McKendrick (n 305) 51.
[765] Smith and Leslie (n 310) 2.78.
[766] Enforceable by a party who has lost possession of physical chattels.
[767] Smith and Leslie (n 310) 2.78.
[768] ibid 2.78. The Act fused the old courts of common law and equity into a single Supreme Court of Judicature.
[769] ibid 26–29.
[770] ibid 36.
[771] ibid 30. Smith and Leslie argue that since an equitable right is enforced *in personam*, it can be claimed or enforced only by action (i.e. that all equitable rights are choses in action).
[772] ibid 28, footnote 77.

before the transferee is registered where such a contract is enforceable by an order of specific performance.[773]

8.2.2 Registered securities

Financial collateral can be held in two ways: directly (registered) or indirectly (intermediated). The question is how this fit into the possibility of a TTFCA under English law. We will start off with registered securities below ; intermediated securities will be considered later.

'Registered securities' refers to securities which are directly held, that is, where the investor is registered as a member and shareholder of the issuer. Under English law, such securities may be issued in certificated or uncertificated form. A certificated issue is where a shareholder is registered, and a paper certificate is issued as proof of his membership. Uncertificated shares are shares issued in dematerialised form under the Uncertificated Securities Regulations 2001 (USR 2001). In the UK, the dematerialisation of securities is facilitated through CREST.[774]

CREST maintains a direct holding system in the UK. This implies that it merely acts as an interface between the issuer and the investors. Therefore, regardless of the dematerialisation of the securities, CREST members retain a direct relationship with the issuer. The relationship between the issuer and the investor is the same as if a certificated security has been issued.

The Companies Act 2006 regulates the issuance of shares by companies and applies to both Scotland and England. Under the Act, shares are described as incorporeal movables under Scots law, and personal property under English law.[775] There is an agreement in English and Scots law that a 'share is an interest of a shareholder in the company measured by a sum of money, to liability in the first place and of interest in the second, but also consisting of a series of mutual covenants' between the shareholders.[776] Therefore, shares are normally described as an item of property that consist of various rights against the company and other shareholders. These various bundles of rights, such as the right to vote at the company's meetings or to receive dividends, do not confer on the shareholder ownership rights in the company or

[773] *Sainsbury plc v O'Connor (Inspector of Taxes)* (1991) 1 WLR 963; Micheler (n 760) 38.
[774] See M Chamberlain, 'CREST', *Tolley's Company Law*, C 8001-C8042 for a detailed explanation.
[775] Companies Act 2006, s. 541.
[776] *Borland's Trustee v Steel Bros & Co Ltd* (1901) 1 Ch 279; referred to by Nicholas Grier, *Company Law* (3rd edn, W Green 2011) 96 on Scots law.

ownership of the company as a thing. They merely confer on the share itself a value which makes the share attractive as a property object.[777]

8.2.2.1 Registered securities: TTFCA as the transfer of legal ownership

As mentioned previously, the UK regulations define a TTFCA as the transfer of 'legal and beneficial ownership'. This indicates that for there to be a TTFCA of registered shares, there must be the transfer of both legal and beneficial ownership. This discussion below is premised on a situation where there is only legal interest, or registered interest, in the collateral. Can such a party be said to have both 'legal and beneficial ownership'?

Legal title to shares is vested in the person who is entitled to it by allotment or by transfer and who registers his interest in the company's register of members.[778] Micheler states that in English law, the register of member is the focal point of acquisition of legal title. Legal title is vested in a buyer of securities once his name is registered.[779] In *J Sainsbury plc v O' Connor (Inspector of Taxes)*, Nourse LJ likewise held that in English law, there is 'no difficulty in ascertaining the legal ownership of shares, which is invariably vested in the registered holder'.[780]

These views are confirmed by the Companies Act 2006 which provides in section 112 that the members of the company are: a) subscribers to the company's memorandum who have had their names registered; b) and other persons who may have agreed to be members and whose names are registered. This group of persons, by registration, are conferred with legal ownership.

The above provisions denote that the Companies Act 2006 is concerned only with legal ownership, as opposed to legal and beneficial ownership. Thus, any transfer of registered securities necessarily involves the transfer of legal ownership. By section 126 of the Companies Act 2006, there is an express exclusion of the trust and any interest in equity from the provisions of the Companies Act 2006. The section provides that '[n]o notice of any trust, express, implied or constructive, shall be entered on the register of members of a company registered in England and Wales or Northern Ireland, or be receivable by the registrar'. This provision seems to endorse the view that the Companies Act 2006 deals only with legal ownership. Smith and

[777] Sarah Worthington, 'Shares and Shareholders: Property, Power and Entitlement: Part 1' (2001) 22 Company Lawyer 258, 258.
[778] Robert Pennington, *Pennington's Company Law* (8th edn, Butterworths Law 2001) 394.
[779] Micheler (n 760) 38.
[780] *Sainsbury plc v O'Connor (Inspector of Taxes)* (n 773) 977.

Leslie, in referring to section 126 above, note that 'there can be little doubt that it applies to all equitable interests as well'.[781] Thus, any transfer of registered securities must necessarily transfer only legal ownership in those securities. Be that as it may, it implies that contrary to the UK Regulations, only legal ownership can be transferred for registered securities as opposed to legal and beneficial ownership.

In the section below, we will consider how beneficial ownership arises in respect of the transfer of registered securities. The analysis suggests that beneficial ownership may be said to be 'engrafted' rather than carved out from legal ownership. This endorses Swadling's view above.

8.2.2.2 Equitable ownership in a transfer

It is important to note that the use of the CREST system has minimised the 'practical significance'[782] of when equitable ownership arises for uncertificated transfers. This is because the delay occasioned between the time securities are sold and when they are completed has reduced. This normally now takes three working days represented (T+3) i.e. trade date plus 3 days). It is also possible that such transfers may be settled earlier since they are done electronically.[783] As such, what is required is to match buy bids with available securities. This short timeframe therefore makes it difficult for equitable interests to arise. Such interests were historically invoked when transfers were done using paper documents. Regardless of this modern development, equitable ownership still arises for electronic transfers, even if it is for a 'comparatively short time span' between the times the securities are sold and when they are delivered.[784] The USR, reg. 31(2), for example, provides that a transferor shall retain legal title in the securities before the transferee's name is registered, and that the transferee shall have equitable interest in those securities before such registration.

Equitable ownership therefore arises in relation to registered securities where a transfer is not completed. In a transfer, there are usually three stages: the contract of sale; delivery of signed transfer forms; and registration in the shareholder's register.[785] As earlier noted, section 112 of the Companies Act 2006 provides that a person becomes a member of a company once he has so agreed and his name is registered. The Act does not take the agreement of the parties

[781] Smith and Leslie (n 310) para 19.182.
[782] Micheler (n 760) 72.
[783] ibid.
[784] ibid.
[785] Paul Davies and Sarah Worthington (eds), *Gower & Davies: Principles of Modern Company Law* (9th edn, Sweet & Maxwell Ltd 2012) 992.

as constitutive of legal title. Instead it regards registration as conferring legal ownership. Generally, a buyer becomes equitable owner if the agreement is specifically enforceable. In *J. Sainsbury plc v O'Connor (Inspector of Taxes)*,[786] the court stated that an equitable owner means 'the purchaser under a specifically enforceable contract'. Thus, the ownership right arises not from registration but from the contract between the parties.

An order for specific performance will only be made where a) the contract is enforceable, b) there has been consideration given, c) damages will be an inadequate remedy, and d) the collateral has been identified.[787] Where these requirements are established, a constructive trust (i.e. a beneficial interest) arises in favour of the buyer. In *Oughtred v Inland Revenue Commissioners*[788] the court held that:

> 'The constructive trust in favour of a purchaser which arises on the conclusion of a contract for sale is founded upon the purchaser's right to enforce the contract in proceedings for specific performance. In other words, he is treated in equity as entitled by virtue of the contract to the property which the vendor is bound under the contract to convey to him. This interest under the contract is no doubt a proprietary interest of a sort, which arises, so to speak, in anticipation of the execution of the transfer for which the purchaser is entitled to call.'

This decision suggests that the beneficiary's right does not arise from the legal ownership. It is founded upon a separate right to enforce the contract. In other words, instead of being a right which is carved out of the legal ownership, it is imposed on the seller's right. Like Swadling's metaphor above, one may suggest that this right is 'engrafted' on the legal ownership.

In summary, the above analysis indicates that for registered securities: first, the Companies Act 2006 deals with only legal ownership; secondly, even where it is only one party (registered holder) who has an interest in the financial collateral, the party's interest can only be legal ownership, not legal and beneficial ownership. This conclusion is supported by the fact that where beneficial ownership arises, it arises not from the right of the collateral taker but is supposedly triggered by the breach of the contract of sale.

8.2.3 Book-entry securities in English law and legal and beneficial ownership

The previous section on registered securities examines the meaning of 'legal and beneficial ownership' in the Regulations from the perspective of the legal title holder. The discussion below provides another example where the definition may not be appropriate.

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[786] *Sainsbury plc v O'Connor (Inspector of Taxes)* (n 773) 972.
[787] Micheler (n 760) 38.
[788] *Oughtred v Inland Revenue Commissioners* [1960] AC 206; Micheler (n 760) 39.

An intermediated holding structure was described in section 5.3.2. It was highlighted that at the lower-tier are intermediaries, who have interests in the same securities. In an economic sense, the securities are the same but are conceptually different.[789] Because of the multi-layered structure, the issue arises as to how to characterise the rights of the intermediaries/investor.

Under English law, there is the 'general agreement that the best analysis' of book entry securities is that of a trust. [790] It is argued that as a general concept, the intermediary is a trustee for the investor who is seen as the beneficiary. This analysis applies both to the first and lower-tier intermediaries. In Gullifer's opinion, the long chain of intermediation may be explained using a sub-trust: A holds property on trust for B, and B holds on sub-trust for C; C likewise holds for D, and so on. The investor's right under the sub-trust is exercisable only against his own sub-trustee and not against a party in the upper chain.[791] The English courts have upheld this position.[792] In *Pearson & others v Lehman Brothers Finance SA*[793] Briggs J stated:

> 'It is common ground that a trust may exist not merely between legal owner and ultimate beneficial owner but each stage of a chain between them, so that, for example, A may hold on trust for X, X on trust for Y and Y on trust for B. The only true trust (i.e. of the legal right) is that of A for X. At each lower stage in the chain, the intermediate trustee holds on trust only his interest in the property held on trust for him. That is the how the holding of intermediated securities works under English law[…]'

Gullifer argues that the above analysis has three consequences: first, the beneficiary's right derives from the intermediary's right directly above it (i.e. its trustee or sub-trustee); secondly, the beneficiary's right is linked to the original right embodied by the securities; thirdly, this linkage does not mean that the intermediary may 'look through' to an upper-tier intermediary, that is, claim some rights against an intermediary higher than its own direct intermediary.

The important question here is whether a transfer by a lower tier intermediary qualifies as a TTFCA based on the definition in the Regulations. As earlier noted, a TTFCA is defined as the transfer of legal and beneficial ownership.

As noted above, the beneficiary in intermediated securities has only beneficial ownership. The legal title is vested in the first-tier intermediary registered with the issuer of securities. That

[789] Benjamin (n 258) para 1.107 and Chapter 2.
[790] Gullifer, 'Protection of Investors in Intermediated Securities' (n 337) 230–231; Smith and Leslie (n 310) para 6.187.
[791] Smith and Leslie (n 310) para 6.190.
[792] *Re Lehman Brothers International (Europe) (Admin)* [2009] EWHC 2545 (Ch) [49–72]; *Re Lehman Brothers International (in Admin)* [2010] EWHC 2914 (Ch) [226].
[793][2010] EWHC 2914.

being the case, it means that a TTFCA at the lower-tier can only transfer beneficial ownership, rather than legal and beneficial ownership as stated by the Regulations. Recognising this problem, Gullifer notes that the drafting of the Regulations 'causes difficulty'.[794] In her view, 'since intermediated securities are, on the accepted analysis under English law, equitable interests under a trust or sub-trust, it is difficult to see how legal ownership (as opposed to beneficial ownership) can be transferred.'[795]She therefore suggests that the definition in the Regulations should be interpreted as 'full ownership or full beneficial ownership'.[796] Similarly, Ho identifies the problem, but suggests that the appropriate term should be 'legal (if applicable) and beneficial ownership'.[797]

Literally, Gullifer's suggestion above gives a false impression when seen within the context of the Directive. First, it suggests, on the one hand, that that there can be 'full ownership' which on the face of it complies with the Directive. More importantly, it also suggests that there can be 'full beneficial ownership' which is not full ownership. Essentially, while the former complies with the Directive, the latter does not. The two alternatives may serve their respective purposes under English law. However, they are also suggestive of how systems achieve the result set out by directives using their own doctrinal principles.

Ho additionally proffers an alternative interpretation, i.e. 'legal (if applicable) and beneficial ownership'. This interpretation suggests that there are situations where the 'legal title' is not applicable. However, even in intermediated securities, the legal title always resides in the first-tier intermediary. Similarly, as mentioned earlier, an underlying idea behind beneficial ownership is that it is divided ownership. [798] That is to say that without legal ownership, there cannot be beneficial ownership; beneficial ownership is always suggestive of the fact that there is legal ownership somewhere.

8.3 TTFCA AS ABSOLUTE INTERESTS

Regardless of the foregoing discussions, English law recognises that a beneficial owner in an intermediated structure, or a legal owner in a directly held structure, can create a TTFCA, or an absolute interest, or an outright interest.[799] As mentioned in the previous chapter, the consensus is that the distinction between a TTFCA and an SFCA reflects the distinction

[794] Gullifer, *Goode and Gullifer* (n 275) para 6.38.
[795] ibid.
[796] ibid.
[797] Ho (n 301) 164.
[798] McKendrick (n 305) 42. Goode expresses this view on the position in English law generally, not with reference to the Regulations.
[799] Swadling, 'Trust and Ownership' (n 735) 953.

between an absolute interest (a TTFCA) and a security interest (SFCA).[800] An absolute interest is the residue interest out of which security rights and other rights are carved out.[801] In English law, this may be either ownership (legal or equitable) or possession. On the other hand, a limited right is vested in one 'who enjoys merely a specific right': for example, a pledge, lien, mortgage (equitable) or a charge. [802]

'Absolute' interest presupposes that the right-holder has an entitlement to the property not limited by the interest of another. However, it is ironical to talk about 'absolute' interests in a system where there are different titles. Therefore, one question is: how can interest be absolute where the right of the beneficiary presupposes that another party has a superior title? The answer to this may be that that the question itself necessarily presupposes that 'absolute' connotes an interest which is indefeasible. This type of view proceeds on the basis of the Civil law ownership concept. Within the context of English law, the phrase has a different meaning, which in some sense does not contradict the relativity of title between competing valid titles. Thus, although title is relative between a legal owner and beneficial owner; independently, each of the title-holders has an interest which is akin to Civil law ownership and therefore can create a TTFCA or an absolute interest. Therefore, the phrase 'absolute interest' does not connote an indefeasible right. Rather, it refers to a residual interest out of which smaller rights are created.

The idea of absolute interest in English law contrasts with the idea of a limited right, rather than any idea of unitary ownership. This is because it is not fruitful to talk about 'absolute' title where, for example, the beneficiary's ownership may be defeasible by legal ownership. However, between a party who has a limited right and another who has an absolute right, apparently the latter's right is absolute. Thus, regardless of the number of limited rights which may be created out of such an absolute right, it is a residual right, remaining even after the limited right has extinguished.

The following conclusions can be drawn from this: First, in relation to the legal mortgage the above will endorse the view that the equity of redemption is a primary right, therefore a legal mortgage is not an outright transfer despite the fact that what is transferred is legal ownership. Thus, because the 'absolute interest' remains in the beneficiary, the legal ownership is transferred simply for the purpose of security.

[800] Gullifer, 'Financial Collateral' (n 11) 384.
[801] McKendrick (n 305) 34.
[802] ibid.

Secondly, in relation to directly held securities and intermediated securities: a legal owner and beneficial owner can both transfer an absolute interest in the collateral under a TTFCA because their rights are residuary.

8.4 CONCLUSION

As discussed in chapter two, in reconstructing institutions, the functional method takes an outsider perspective.The analysis above demonstrates that the functional definition of a TTFCA in the Directive, based on the two conditions of applicability, may not fit in well within English law when seen simply from the outsider perspective of the Directive. In a practical sense, Akkermans' opinion mentioned earlier that a legal mortgage is a TTFCA shows the risk of taking such an outsider perspective. But as demonstrated in this chapter, although the definition of a TTFCA in the Directive gives rise to potential risk that it may be seen as a legal mortgage, to avoid that risk there is need to have recourse to English legal doctrines from the standpoint of the UK Implementing Regulations.

It was argued that, conceptually, for the risk not to arise, the equity of redemption needs to be seen as a residual right, rather than personal right, which trumps the legal ownership of the collateral taker. This is so notwithstanding that legal ownership is generally considered to be the primary right in other cases. It is only when the equity of redemption is interpreted in this light that the definition in the UK Implementing Regulations prevents the potential risk in the Directive, although as discussed, the definition, as it is, causes difficulties in the context of a legal title holder for registered shares and a beneficiary right in intermediated securities.

The discussion in this chapter demonstrates that the functional definition of a TTFCA in the Directive cannot be seen in terms of the specific effects or criteria, as provided in the Directive, but with the help of English doctrinal principles, taking an insider perspective

9 CHAPTER NINE: BY WAY OF SECURITY AS A SYSTEM-NEUTRAL CONCEPT?

9.1 INTRODUCTION: COLLATERAL DIRECTIVE AND SFCA

In chapter four, it was noted that the objective of the Directive was to prevent a TTFCA from being undermined. This was in regard to the so-called risk of recharacterisation present in some Member States, by virtue of which the rules for the constitution of security devices were applied by analogy to such arrangements. As further noted, it is the similarity in the function performed by a TTFCA and an SFCA (i.e. both are security arrangements) that gives rise to the risk of recharacterisation. In chapters seven and eight, we considered the more concrete issues of the potential tension which may arise in identifying the TTFCA. It was noted that the Collateral Directive structures itself by contrasting between a TTFCA and an SFCA in the presumption that the arrangements are different and thus ought to be recognised by the Member States as giving rise to different legal consequences. The Directive, on the one hand, defines a TTFCA as an arrangement under which a collateral provider transfers full ownership of financial collateral for the purpose of securing or covering a relevant financial obligation.[803] On the contrary, the Directive defines an SFCA as:

> [A]n arrangement under which the collateral provider provides financial collateral by way of security to or in favour of the collateral taker, and where the full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral provider when the security right is established.

Two phrases are key to the SFCA from the above definition: that is, 'provides by way of security' and where the 'full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral taker'.

The difference between a TTFCA and a SFCA is not the function which they perform: they both provide collateral for the purpose of securing an obligation. The difference, rather, is the way the collateral is provided. In a TTFCA, the provision of collateral is done by a transfer of full ownership, as defined in the Directive. On the contrary, in an SFCA, the Directive states that the provision of collateral is done 'by way of security'. Importantly, the Directive further

[803] Collateral Directive, article 2(1) b.

provides that in an SFCA, the collateral provider retains ownership after such provision of collateral by way of security.

As suggested in chapters seven and eight, there are borderline cases which may not adequately fall within the definition of an SFCA, that is, a *fiducia cum creditore* [804] and a legal mortgage. Both transactions are transfers but are 'recharacterised' as security devices by English law and pre-1992 Dutch law. This suggests that what amounts to an SFCA is system-dependent. However, as suggested by the functional method, we should be able to identify a system-neutral definition of an SFCA at the level of the Directive. Defining an SFCA based on the laws of Member States may create instability and make it difficult to identify a broad, system-neutral meaning for which every system ought to recognise. The question then arises as to how to arrive at a system-neutral definition of an SFCA based on the drafting of the Directive. As will be demonstrated below, because the first element above ('by way of security') provides little guidance on the meaning of an SFCA, the second requirement on ownership retention becomes useful.

This chapter therefore broadly focuses on the SFCA and the meaning of that term in the Directive. As already suggested, the primary aim of this is to test the assumptions of the functional method, to consider if legal institutions are indeed system-neutral.

9.2 RECHARACTERISATION AS A MOTIVATING FACTOR FOR THE SFCA

There has been little or no analysis on the meaning of the SFCA in the Directive. This may not be surprising. As Gretton notes, the major aim of the Directive was to legitimise a TTFCA which is seen as more appealing than an SFCA.[805] As noted in sections 4.1- 4.3, the reasons for this are: one, there are less onerous publicity conditions for the constitution of TTFCAs in many Member States, compared to security devices; secondly, under a TTFCA, a collateral taker is under fewer restrictions regarding the use of the collateral. This has a wider market impact, as it increases free use and liquidity in the financial markets. Therefore, many of the provisions in the Directive on the SFCA are rules which close the gap between an SFCA and a TTFCA. As mentioned in section 1.2, some of the rules relate to the disapplication of the formality requirements which normally apply to security devices; the recognition of a right of

[804] That is under pre-1992 Dutch law.
[805] Gretton, 'Financial Collateral' (n 263) 211.

use under an SFCA [806] and the lessening of the rules on realisation of assets in an SFCA.[807] Essentially, these requirements draw an SFCA closer to a TTFCA.

The TTFCA therefore offers more appeal than an SFCA. This makes it less surprising that questions regarding the risk of recharacterisation, which was discussed in chapter four, will arise mostly in relation to a TTFCA and, more importantly, whether it amounts to a security interest. In systems where there is the risk of recharacterisation, such as the Netherlands, as seen in chapter seven, similar questions arise as to whether a *fiducia cum creditore* amounts to security right.[808]

The risk of recharacterisation is premised on certain underlying issues. First, as a result of the close economic similarity between a TTFCA and traditional security devices. Secondly, it also arises as a result of the approach adopted by a system in characterising a secured transaction. As discussed in chapter four, there are two approaches: formal and functional. Adopting a functional approach makes it likely that a TTFCA will be recharacterised as a security device, because it performs a security function.

Although both a TTFCA and an SFCA perform security functions, the Directive contrasts both arrangements on the underlying assumptions that they both give rise to different consequences. This generally indicates that the Directive adopts a formal approach, as discussed in chapter four and section 7.2. It therefore presupposes that there is a clear conceptual difference between both arrangements. However, the question is whether regardless of the formal approach, which is presupposed by the Directive, clear markers can be made out regarding what amounts to an SFCA in the Directive.

9.3 SFCA AS 'BY WAY OF SECURITY' AND OWNERSHIP RETENTION

As noted, the Directive defines an SFCA as an arrangement under which the collateral provider provides financial collateral by way of security to or in favour of the collateral taker, and where the full or qualified ownership remains in the collateral provider. Two key requirements can be made out from this definition: first, that the collateral is provided 'by way of security'; and secondly, the collateral provider must retain ownership of the collateral. The presence of the conjunction 'and' in the definition implies that both requirements are necessary to identify an SFCA.

[806] Collateral Directive, article 5.
[807] Collateral Directive, article 4
[808] Which as argued earlier is a TTFCA.

However, there are ambiguities which arise from separating these two elements, especially in the light of the conjunction 'and'. The inclusion of that conjunction implies that it is possible to have the two elements separately, that is, to have a provision 'by way of security', but where the full ownership does not remain with the collateral provider. This further implies there can be provision 'by way of security' which is not an SFCA, because the collateral provider does not retain ownership. However, if retention of ownership is a necessary feature of 'by way of security', the second requirement may be said to be redundant.

Underlying the above analysis is the question: what does it mean to provide collateral 'by way of security', since the issue has consequences for whether the second requirement above is redundant.

9.3.1 "By way of security" as system dependent?

The phrase 'by way of security', as suggested, is a key element in identifying an SFCA. Based on the assumptions of the functional theory, any meaning of that phrase ought to be system-neutral, to make it possible for each individual legal system to identify the legal institution. However, the Directive, as noted, does not provide any definition of that phrase. Based on the drafting of the Directive, the phrase suggests that an SFCA performs a security function. However, as earlier noted, a TTFCA is defined by the Directive in a similar way as a device which is used to secure an obligation. Thus, because the Directive treats the two devices as conceptually different, the expectation is that the phrase 'by way of security' should imply something more than a device performing a security function. However, because of the lack of detail in the Directive regarding the phrase, the second requirement on ownership retention, as will be seen below, becomes a useful guide in directly (Keijser) or indirectly (MacLeod, Gretton)[809] identifying what an SFCA is.

As discussed below, the different translations of the Directive, especially the German, reflect some contextual uniqueness of an SFCA. As mentioned, the English version of the Directive uses the term 'by way of security' in defining an SFCA. However, this phrase is not different from the definition of an TTFCA, which is defined in a similar way . The English version of the Directive therefore makes it difficult to determine the difference between both transactions and what amounts to an SFCA.

The French and German versions also provide different definitions of an SFCA. The French version defines it thus:

[809] Both MacLeod and Gretton write on what constitutes a security right as opposed to 'by way of security'. However, as discussed below, the phrase 'by way of security' presupposes a concept of security for which they both write on.

> *contrat de garantie financière avec constitution de sûreté", un contrat par lequel le constituant fournit au preneur, ou en faveur de celui-ci, la garantie financière sous la forme d'une sûreté, et où le constituant conserve la pleine propriété ou la propriété restreinte de cette garantie financière, ou le droit intégral à cette dernière, lorsque le droit afférent à cette sûreté est établi*

The German version, on the other hand, defines it as:

> *Finanzsicherheit in Form eines beschränkten dinglichen Rechts' ist ein Sicherungsrecht an einem Finanzaktivum durch einen Sicherungsgeber, wobei das volle oder bedingte/beschränkte Eigentum oder die Inhaberschaft an der Sicherheit zum Zeitpunkt der Bestellung beim Sicherungsgeber verbleibt*

Unlike the English version which uses the phrase 'by way of security', the French version uses a different terminology: *'d'une sûreté'* which may loosely translate to 'security interest' or simply a security. However, like the English version, this provides little guidance, since a TTFCA also performs a security function, as already noted. Importantly, the German version, on the other hand, uses the term '*beschränkten dinglichen Rechts'* which translates to a 'limited real right'.[810] This presupposes a subordinate real right derived from ownership.

From a functional perspective, since each version of the Directive is to have the same effect in each system, regardless of the language, this implies that the German or French or English versions respectively apply in the same way in each system. While both the French and English versions provide little explanation, the German version provides that the phrase represents a 'limited real right' which is akin to a subordinate real right or a security interest. Therefore, unlike the English version, wide enough to cover a TTFCA, the German phrase is suggestive of a 'limited real right' in financial collateral. Essentially, the German version, since it offers a more useful guide, can be used to understand what the English version means: the institutions are presupposed to be functionally equivalent.[811]

A 'limited real right' presupposes a property right derived from ownership. In many Civil law systems, these may be a right of easement or usufruct or a security right. Under these devices, a right is created which is subordinated to the ownership right.

[810] Translation obtained from: Gretton, 'Ownership and Its Objects' (n 307) 828.
[811] Under German law, there cannot be real right over incorporeals. However, an exception to this rule is security rights over incorporeals. ibid 820.

In line with the functional theory, the important question is: how can a system-neutral concept of a right in security be identified, as presupposed by the Directive?

What amounts to a right in security is very controversial.[812] There is a controversy regarding the functional or formal approach in characterising security rights and the policy choices regarding the suitable option to adopt. Importantly, these controversies suggest that there is no uniform rule on the concept of security. What amounts to a security device, and the organising principles on which that concept is based, may be dependent on each individual system.

In all European legal systems, there is a category of devices called 'rights in security' existing in different forms. In many Civil law systems, there is the right of pledge which may be taken over both corporeal [813] and incorporeal [814] property, although Scots law, influenced by the Civilian tradition, is yet to introduce such a device for incorporeal movables.[815] In the Civil law system, there is also the *hypothec*[816] which may be taken over immovable property.[817] In Scotland, such a right in security is called a standard security.[818]

In the Civil law tradition, there is a debate about what constitutes a right in security.[819] In his discussion on Dutch and German law, Keijser argues that a right in security shares

[812] There are debates about the two broad approaches (functional and formal): for example, see the old debate between Allan and Goode: David Allan, 'Security: Some Mysteries, Myths and Monstrosities' (1989) 12 Monash ULR 337; Roy Goode, 'Security: A Pragmatic Conceptualist Response' (1989) 15 Monash ULR 361. And there are also debates about the boundaries of the concept, what it captures and what it does not, and its requirements. On Scots law, see Gretton, 'The Concept of Security' (n 712); John MacLeod, 'Thirty Years After: The Concept of Security Revisited' in Andrew Steven, Ross Anderson and John MacLeod (eds), *Nothing So Practical as a Good Theory: Festschrift For George Gretton* (Avizandum Publishing Ltd 2017) 177.

[813] § 1204 BGB for German law; Article 3:227 of the Dutch Civil Code for Dutch Law; Article 2333 for the French Civil Code. There is also an equivalent institution in Scots and English law characterised as the pledge; for Scots law, see David Carey-Miller, *Corporeal Moveables in Scots Law* (2nd edn, W Green 2005) paras 11.04-11–12; for English law, see Beale and others (n 279) paras 5.01-5.61.

[814] For incorporeal property such as claims: see Article 2355 French Civil Code; Article 3:94 for Dutch Civil Code; § 1273 BGB for the German Civil Code which applies by analogy the rules applicable to the pledge of corporeal to the pledge of incorporeal property.

[815] The Scottish Law Commission recommends that a pledge be introduced for such incorporeal property. See the Scottish Law Commission *Report on Moveable Transactions*, Vol 3 (and s. 43 of the Draft Bill on Movable Transactions).

[816] See § 1113 BGB for German law; Article 2393 of the French Civil Code; Article 3:227 for the Dutch Civil Code.

[817] Erp and Akkermans (n 330) 536.

[818] See Conveyancing and Feudal Reform (Scotland) Act 1970 (as amended), s 9.

[819] For some brief historical comments on Scots law (which forms part of the Civil Law tradition), see MacLeod (n 812) 177–193. There are different positions in Scots law, some of which align more or less with the European tradition. For example, see MacLeod's comments on Forbes (in Scots law) and the similarity between Forbes and Windscheid at page 185 of MacLeod's article.

functional features. According to him, these features are the accessory relationship between the right of pledge and the secured debt;[820] a duty of care on the collateral taker to take care of the asset and not to deal with it in a way contrary to the security right; the right of redemption on the collateral provider to call for a return of the assets; a right to sell the collateral upon default by the collateral provider; and restrictions on the collateral taker from appropriating the assets upon default.[821]

However, MacLeod has argued that it is not fruitful to argue in terms of these effects or what the right-holder can do (an approach endorsed by the functional method) but rather the reasons why the right-holder can exercise those rights. According to him, the 'essence of the right in security […] is its purpose'.[822] It is this purpose which brings together the many rules and the effects which govern a right in security.[823] MacLeod accepts the wider European tradition that a security right has the purpose of appropriation for security or to secure an entitlement only in order that another right will be satisfied.[824] Thus, a right in security finds its fulfilment not in itself, but towards the satisfaction of another right (debt).[825] Thus, in MacLeod's view, understanding a right in security as such explains some of the rules connected with it, such as the accessoriness principle seen above in Keijser's position. In this regard, MacLeod argues that if some value can be obtained from the secured asset without any reference to the debt, then the right is not a right in security, but is more akin to a use-right defined by what the holder of the right can do rather than what the right is for.[826]

MacLeod's purposive approach is not necessarily at variance with Gretton's definition of a proper security seen in chapter seven or even Keijser's position above. Both Gretton and Keijser's position above can be accommodated within the purposive approach advocated by MacLeod. MacLeod's approach finds an organising principle around which the rules which are ascribed to a right in security (such as the publicity rules or restraint on the use of the burdened property by the collateral taker) are based. Thus, those rules are carved out by the law in reaction to the purpose of the institution, just as the rules on transfer are carved out by the law in response to the purpose served by that institution. The approach also offers some explanatory basis for why rights in security, according to Gretton, may be described as a 'real right in the

[820] This has the effect that the right ceases to exist once the secured debt is paid off.
[821] Keijser (n 96) 97–100. Keijser also identifies other features, such as the survival of the right even when it is vested in a successor.
[822] MacLeod (n 812) 185.
[823] ibid 185,189.
[824] ibid 185–186.
[825] ibid 192.
[826] ibid 189.

property of another person[….]' (In effect giving rise to an additional real right.)[827] Thus, the purpose of the additional real right is to secure a debt in the debtor's property.

The Directive, as earlier suggested, prescribes two requirements in identifying an SFCA: first, the collateral must be provided by way of security, and secondly, the collateral provider must retain ownership of the collateral. These requirements are not outwith MacLeod's purposive approach above. As noted, the purpose of a right in security is to satisfy another right. For this purpose, the right therefore merely burdens the right of the collateral provider. Since this is its key quality, it means the collateral provider necessarily retains ownership of the property. In other words, the retention of ownership requirement, in the Directive, as a separate element is redundant.

As earlier highlighted, the conjunction 'and' in the Directive suggests that there can be provision 'by way of security' which is not an SFCA, because for example ownership is not retained by the collateral provider. However, as the analysis above suggests, provided the secured assets are the debtor's,[828] retention of ownership by the collateral provider is a necessary feature of a right in security, allowing such rules as the accessory principle to apply. The 'and' in the Directive is therefore, as already suggested, unnecessary, since provision 'by way of security' implies ownership remains with the collateral provider, in MacLeod's account.

MacLeod's purposive approach therefore draws a conceptual distinction between a right in security and a transfer. According to MacLeod, satisfaction of the right is the law's purpose in recognising a right in security (i.e. an SFCA); while in a transfer, satisfaction of the right is the parties' purpose in employing it (TTFCA). For functional securities, particularly *fiducia cum creditore* which is a transfer, MacLeod suggests that they are not rights in security since it is the parties who repurpose the institution in satisfaction of an obligation. Such an institution is not a right in security but is a transfer, and this explains the rules which the law has designed for such devices.

However, it may be argued that the gap between a right in security and a transfer is not always clearly demarcated. There are institutions which operate as transfers, but which the law deems to exist for the purpose of the satisfaction of another right. Around this purpose, the law applies the traditional rules applicable to rights in security to such institutions. Examples of such institutions are the legal mortgage under English law or the *fiducia cum creditore* under

[827] See MacPherson (n 705) (footnote 40 in his article). He notes that rights in security in Scots law require the grant of a real right.
[828] A right in security may burden property belonging to another party, who may grant the security in favour of the debtor.

pre-1992 Dutch law, as discussed in chapters seven and eight. These institutions are strictly transfers, but the law, especially English law, treats the institution as giving rise to a security. What this implies is that there may be multiple types of transfer, with different purposes recognised by the law. It is therefore questionable if there is indeed a clear difference between the law's purpose for rights in security proper and the law's purpose for such transfers. Both institutions can as well be said to revolve around the same organising principle.

The above suggests that MacLeod's purposive approach may be restrictive in terms of identifying a system-neutral meaning of a right in security. As noted above, he defines a right in security in terms of the law's purpose in recognising the right. However, the approach begs the question: whose purpose? The law's purpose may differ from system to system (as seen in the case of the legal mortgage above), and it may be difficult to identify one single purpose which can cuts across different systems. It may therefore be fruitful to discuss in terms of the law's purpose when a system-dependent approach is taken.[829]

The above analysis has implications for the Directive. As mentioned, the Directive suggests that ownership retention is a marker for an SFCA. However, as discussed above, this may not be the case, especially in the case of a legal mortgage which operates by way of transfer of 'ownership'.[830] Thus, although ownership retention may be a necessary marker for what constitutes a 'limited real right' in many Civil law systems, the peculiar nature of ownership in English law and the legal mortgage means that a security right can arise even where ownership is supposedly transferred.

The above analysis suggests that what amounts to 'by way of security' , at the level of the Directive, is system-dependent. MacLeod's purposive approach, which strongly tallies with the provisions of the Directive, may well be founded in many Civil law systems where there is a clear demarcation between a transfer and a right in security, because of the Civil law's *a priori* which defines concepts in terms of specific categories. However, it is questionable if a sharp boundary operates in English law.

In English law, it is controversial whether there is a concept of security. If indeed there is one , this ought to have been identified, most especially in a notable text by Goode and Gullifer, where there is a discussion on the 'concept of security'. [831] However, both authors

[829] MacLeod writes from the perspective of Scots law, therefore the above inadequacy may be justified on that basis.
[830] As seen in the previous chapter, a legal mortgage is defined as a transfer in English law.
[831] See Gullifer, *Goode and Gullifer* (n 275) ch 2 para 1.17 titled 'Concept of Security'. The phrase 'concept of security' suggests a concept which can be found in the disparate security institutions existing in English law.

define a security right based on its effects, similar to Keijser above. According to Goode and Gullifer certain legal features need to be present to identify a security right in the Common law: first, the right ought to be a right granted by a collateral provider to a collateral taker; secondly, the right is by way of a grant, not by reservation; thirdly, it is given for the purpose of securing an obligation; fourthly, the asset is given by way of security, not by an outright transfer; and lastly, the agreement restricts the debtor's right to dispose of the asset.[832] Both Goode and Gullifer argue that it is on these principles that English law identifies the four types of security rights i.e. the pledge;[833] the lien, charge and mortgage. However, as seen below, McCormack suggests that while these particular effects may be easy to state, they are often difficult to identify.[834]

McCormack defines a security right in English law as a right over property which is intended to ensure the performance of some obligation.[835] This definition is not different from the definition of Beale *w*ho similarly defines a security right as a right *in rem* granted by the owner of the property to a creditor to secure an obligation defeasible upon the performance of the obligation. [836] However, these definitions define security in terms of its economic function and thus do not clearly demarcate a TTFCA and an SFCA, as earlier observed, since both perform the same economic function.

Because of the difficulty in identifying a concept of security in English law, it has been suggested that there is 'no clear touchstone by which it can necessarily and inevitably be said that' a security interest has been created in English law. [837] This is because the particular incidences of security rights are not easily ascertainable. However, as highlighted in section 7.2, the court in *Re George Inglefield* [838] identified certain features of a security right in English law. According to the court, the collateral provider in a security device will have the right to a redelivery of the assets upon payment of the debt. Secondly, the collateral taker is under an obligation to account for any surplus after realising the assets. Thirdly, the collateral taker can still go after the collateral provider where there is a shortfall after the realisation of the assets.

[832] ibid 1.17.
[833] Which is the functional equivalent of the Civil law pledge over tangible assets.
[834] McCormack (n 269) 13; see also *Re Cosslett (Contractors) Ltd* (1997) 4 AllER 115, 125.
[835] McCormack (n 269) 1.
[836] Beale and others (n 279) para 4.06.
[837] *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148, 161.
[838] [1933] Ch 1.

However, these elements offer 'very little' help to the problem.[839] Some of the incidences may be replicated in transactions which are not security devices. For instance, in *Alderson v White* [840] the court held that 'an absolute conveyance containing nothing to show that the relation of debtor and creditor is to exist between the parties does not cease to be an absolute conveyance and merely become a mortgage merely because the vendor stipulates that he shall have a right to repurchase'. Furthermore, the presence of a right of recourse in a factoring or discount agreement does not make the transaction a charge. The fact that the transferee can make adjustments and payments to the transferor after the debts have been paid by the debtors does not prevent the transaction from being by way of an outright title transfer.[841]

The above discussion on English law suggests that English law does not have a single concept of security. Rather, it has specific institutions (i.e. the pledge; the lien, charge and mortgage) which serve security functions. As argued in section 4.2, the English courts play an active part in how devices falls within these institutions. This is based on historical factors dealing with the way legal principles develop organically through the courts and the lack of *a priori* conceptualisation of legal concepts. As further argued in section 4.2, this is exacerbated by the fact that is no legislation which provide rules on this issue.

A question arises: if there is no concept of security, on what concepts are the specific security institutions above founded? MacLeod's purposive approach offers an answer to this. In identifying the law's purpose for a security right, MacLeod, referring to MacCormick, distinguishes on the one hand between a collective action which is highly institutionalised and from which a purpose can be 'easily determined', and on the other hand some form of collective action, such as a spontaneous queue, which has no direct institutional framework but is still intelligible in terms of ends or purposes. [842] MacLeod, using this illustration as a metaphor, points out that Scots common law exists somewhere on the spectrum between a highly institutionalised collective action and more spontaneous activities.[843] They have clear rules about the decisions that are significant. The subjects on whom it is binding apply them with reference to the existing body of law. The rules are expanded upon to attend to the ends of the relevant area of law.[844]

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[839] Fidelis Oditah, 'Financing Trade Credit: *Welsh Development Agency v Exfinco*' [1992] JBL 541, 546.
[840] *Alderson v White* (1858) 2 G J 97, 106.
[841] *Lloyds & Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd* (1979) 129 NLJ 366.
[842] MacLeod (n 812) 188 .His view is influenced by MacCormick's theory on legal institutions. See footnotes 50 and 51 in MacLeod's article; MacCormick (n 63) 13-16,83-84.
[843] MacLeod (n 812) 188.
[844] ibid.

English law's approach to security devices can be described in similar terms as the development of Scots common law: there are rules about the decisions that matter, as seen in the criteria set by the court in *Re George Inglefield*. Parties apply those rules with reference to existing security devices. But it is difficult to clearly identify a specific institutionalised concept(s) which bring together all of these security devices. It is the lack of a specific organising principle that makes it difficult to clearly demarcate transfers from security rights in English law, in the way presupposed by the Directive.

It is therefore not surprising that, in contrast to the English law approach, the approach taken by the Directive, as earlier argued, aligns more with MacLeod's highly institutionalised collective action, which resembles the *a priori* approach in the Civil law, from which a clear purpose can be determined. Thus, as earlier argued, the definition of an SFCA, presupposes that there is a clear conceptual demarcation between a transfer (TTFCA) and a security right (SFCA). However, as argued, this may not be the case, in specific reference to a legal mortgage and *fiducia cum creditore* under Dutch law before 1992. Essentially, these discussions suggest that what amounts to 'by way of security' is system-dependent.

However, in the section below, Keijser's attempt to identify a system-neutral definition of security based on the two functions of recoverability and tradability discussed in sections 5.5 and 7.2 will be analysed.

9.3.2 SFCA as 'no tradability' function

MacLeod's account above takes Scots law (and broadly the Civil law) as a starting point for what amounts to a right in security (and indirectly an SFCA). Keijser, on the other hand, attempts to identify what distinguishes a TTFCA from an SFCA by extrapolating some broad principles without reference to any system, although he does this with particular reference to a TTFCA. However, as discussed below, although his definition offers some good indicators to identify an SFCA, Keijser's account is not grounded on the definition of an SFCA in the Directive.

As discussed in sections 5.5 and 7.2, Keijser argues that financial collateral performs two functions. First, it performs a recovery function for recourse purposes. In this regard, it is an asset which may be used in the event the collateral provider defaults. Keijser further argues that financial collateral also performs a tradability function. In this sense they can be used for further trading.[845] As seen in the previous chapter, Keijser argues that it is the tradability

[845] Keijser (n 96) 16–18.

function which distinguishes a TTFCA from a security right. Therefore, according to Keijser, security interests (SFCA) only have a recovery function. The secured party cannot dispose of the secured assets except when a default has occurred.

It is important to note that Keijser's position above is based on his broad perspective of how financial collateral operates in the financial market. He seems to take the above qualities as common and the distinguishing features of a SFCA and a TTFCA.[846] Thus, his analysis suggests that the above distinguishing features may broadly be used to identify the difference between a TTFCA and an SFCA. Therefore, his account is substantially based on market practice rather than being exclusively centred on the Directive.

As Keijser suggests that because it is only a TTFCA that performs a tradability function, this means that an SFCA is an arrangement which does not perform a tradability function: only a TTFCA performs that function. By implication, an SFCA is an arrangement which is not a TTFCA, or an arrangement which performs only a recovery function. However, it cannot be defined as an arrangement which performs a recovery function since both a TTFCA and SFCA perform the same function. Therefore, an SFCA is defined negatively as an arrangement which is not a TTFCA.

The tradability function is deemed to arise because the arrangement is a transfer. It is this feature which distinguishes a TTFCA from an SFCA. This point is endorsed by the Directive. As seen earlier, one key difference between both arrangements is that in an SFCA, ownership remains with the collateral taker. This is the reason why the tradability function does not arise in an SFCA. Therefore, although Keijser's account on tradability is mainly focused on the TTFCA, his analysis also shows, though indirectly like MacLeod's above, the importance of the second requirement on ownership retention to an SFCA. The second requirement will thus appear to be a key requirement in identifying an SFCA, as Keijser suggests.

As noted, the effect of Keijser's analysis is to provide a negative definition of an SFCA. The pitfall in this is that it does not provide any positive content. However, the definition, as well as the scope of application of the Directive, is helpful in identifying an SFCA. First, the Directive applies only to interest in financial collateral, which are intangible property in English and many Civil law system. This restricts the scope of the type of devices which apply to such objects. In most system, a secured creditor may take a pledge or a charge, therefore

[846] This analysis is contained in chapter two of his book on how financial collateral work in the financial markets.

excluding quasi-security devices such as a personal guarantee. Secondly, an SFCA, as Keijser opines, performs only a recovery function. One objection to this view is that a device, such as a personal guarantee, performs a recovery function and may thus be characterised as an SFCA. However, this may not matter within the context of Keijser's analysis. As noted, the Directive applies only to arrangements dealing with the provision of financial collateral. Therefore, the object of the arrangement is financial collateral which must be provided by way of a grant or a transfer to the collateral taker. Although a personal guarantee gives the creditor an additional right against the guarantor in respect of the secured obligation, there is no provision (by way of a grant) of financial collateral, and neither does it relate to an interest in collateral. It is merely an unsecured promise to perform an obligation where the debtor fails to act. Consequently, Keijser's recovery functions may be helpful in identifying an SFCA because of the external parameters regarding the legal acts to constitute an SFCA, in the Directive.

Additionally, Keijser's analysis also requires consideration whether an arrangement performs a tradability function which is only performed by a TTFCA. As noted above, the scope of Directive (i.e. provision of financial collateral) helps to narrow the choice of devices which may apply where the device does not perform a tradability function. In many Civil law systems, this leaves an option of a pledge or a mortgage or charge in English law, which are all security rights in respect of incorporeal moveables or intangible property. As mentioned, applying Keijser's two functions aids in the identification of the institution in question.

However, it may be argued that since Keijser's account does not give us a positive content to work with, it is dependent on the system to provide such a positive content. Thus, because Keijser's account only indicates what an SFCA is not, invariably a system can only evaluate its own institutions against Keijser's conditions to determine if any device satisfies the threshold. Ultimately, any institution which falls within that category must be one provided by the system and is system-dependent. The system plays an active role in the definition of the positive part of such an institution.

Furthermore, the recovery and tradability functions are not based on the drafting of the Directive. As already mentioned, the Directive provides two requirements for an SFCA: first, the collateral is to be provided by way of security, b) and secondly, ownership must remain in the collateral provider. The first requirement suggests that an SFCA performs a recovery function which if accepted may be in line with Keijser's recovery function. However, accepting that interpretation will therefore mean that nothing distinguishes a TTFCA from an SFCA, as already argued. This further defeats the aim of the Directive which supposedly

distinguishes the two arrangements. The phrase 'by way of security' therefore only presupposes something other than a device which performs a recovery function.

It is also questionable how Keijser is able to identify the 'no-tradability' function as an indicator of an SFCA, as this is not based on the provisions of the Directive. However, an objection might be made that Keijser's no-tradability function is founded on the second requirement of ownership retention. Since the collateral provider retains ownership, it implies that the collateral taker cannot use the collateral.

On the above, it is important to note that Keijser himself, as discussed in chapter seven, argues that the *fiducia cum creditore* is a security device. One of the reasons for this, according to him, is because there is a no-tradability function in a *fiducia cum creditore*. If the no-tradability was based on the second element of ownership retention, then a *fiducia cum creditore* is likely not to be a security device. This is because on Keijser's analysis, a *fiducia cum creditore* is a security device although it is a transfer. In other words, the transfer or retention of ownership do not necessarily matter to Keijser in identifying a *fiducia cum creditore* as a security device.

It may be argued that Keijser's no-tradability function is based on contextual, doctrinal presuppositions.[847] For example, he refers to the doctrinal principles in German, English and Dutch law in arguing that in all of these systems, one common characteristic is that a security right is created to secure an obligation. The implication of this is that the property must be returned. He argues that in many systems '[t]he focus may, for example, be on the collateral provider's equity of redemption, on the collateral taker's duty of due care, or on the prohibition of appropriation of collateral assets by the collateral taker'. He adds that these rules are 'merely a question of emphasis, as these different features of security interests are essentially compatible. They give shape to the fiduciary relationship between the parties. They safeguard the ownership interest of the collateral provider and exclude dispositions by the secured party under normal circumstances'.[848]

The above is an example where Keijser refers to doctrinal principles to identify a characteristic of a security right. Two observations can be expressed regarding this: on one hand, the above suggests that what amounts to 'by way of security' is system-dependent. However, this observation may be facile since, as suggested, there are indications from the foregoing discussions that there are indeed functional similarities in how systems approach the issue. Thus, a functional approach may require, as Keijser does, that we look specifically at the practical effects of the phrase

[847] Keijser (n 96) 262.
[848] ibid.

'by way of security'. Obviously, asking such questions directs attention towards the contents or practical effects of the right, which appear to be equivalent in most systems: first, both Keijser and Goode agree that a security right is accessory: it follows the principal obligation. Although systems will normally describe that effect using different terminologies, what that presupposes is that the security rights are not outright transfers. Secondly, both Goode and Keijser also seem to agree that the collateral provider has a right to redeem the collateral. As a corollary of this right, this implies that the collateral taker cannot deal with the assets. Do these functional similarities suggest that a system-neutral meaning can be identified?

Two counter-arguments can be made. First, if institutions are defined by their specific effects, nothing stops us from using not just effects which are similar, but those effects which are different in arriving at a system-neutral meaning. For example, MacLeod notes that even within legal systems, different types of security devices may have different effects. For example, he notes that the holder of a pledge is entitled to possess before the debtor's default, but cannot realise the asset after default. This contrasts with the holder of a standard security, in Scots law, who has no right to possess prior to default, but has the right to sale after default. Obviously, major differences are bound to arise when the comparison is between particular effects in relation to security devices across legal systems. Therefore, if specific institutions give rise to both differences and similarities, there is the question whether a system-neutral idea of the concept of security may be identified in terms of just similar effects. Is this not a presumption of similarity, which as discussed in chapter two, hides a bias towards similarity?

The argument may also be made that defining what amounts to 'by way of security' in terms of the contents of the right may be 'radically over-inclusive'.[849] This is because there are limited rights, such as the right of servitude, which are accessory but are not security rights. Similarly, there are arrangements which vests on a party a right to ask for redelivery, such as an owner's right in a usufruct, which is not a security right. It is therefore questionable if these specific contents provide any indications as to what the phrase 'by way of security' means.

The point above re-echoes MacLeod's argument that instead of asking what the right-holder can do, it is better to ask why that person can do those things. It is in asking that question that we can understand the purpose that bring those specific incidents together. As the discussions in this chapter demonstrate, those principles/purpose will apparently differ from system to system, as demonstrated most especially with reference to a legal mortgage, which, as we saw, contrasts

[849] MacLeod (n 812) 185.

with the presupposition in the Directive (influenced by the Civil law approach) that there is a conceptual distinction between a transfer and a security right.

9.4 Conclusion

The chapter argues that the meaning of an SFCA, based on the two criteria provided by the Directive, are system-dependent. First, the two criteria are based on the presupposition that there is a conceptual distinction between an SFCA and a TTFCA. However, as this chapter demonstrates, this conceptual demarcation is not always clear as there are institutions, such as the legal mortgage, which lie somewhere on the spectrum between these two devices. Secondly, it was also argued that the no-tradability function is not a useful criterion for identifying an SFCA. The reasons for this are: first, that the no-tradability function provides no positive content to work with; secondly, although it is appears to be based on the ownership retention criteria, this cannot be the case, since there are institutions by virtue of which ownership is transferred but which still give rise to the no-tradability function; thirdly, that the function is merely a consequence of a broader principle, rather than being a determinant of what amounts to an SFCA, that is, it is a consequence of applicability, rather than a condition of applicability.

10 CHAPTER TEN: POSSESSION AND CONTROL AS SYSTEM-NEUTRAL CONCEPTS?

10.1 INTRODUCTION

As stated in the previous chapter, the Directive defines an SFCA as an arrangement under which a collateral provider *provides* financial collateral by way of security in favour of a collateral taker. The previous chapter considered the meaning of the phrase 'by way of security'. However, this section considers what it means to 'provide' security. In Article 2(2) of the Directive, an interpretation of this term is provided:

> References in this Directive to financial collateral being 'provided', or to the 'provision' of financial collateral, are to the financial collateral being delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral taker or of a person acting on the collateral taker's behalf. Any right of substitution, right to withdraw excess financial collateral in favour of the collateral provider or, in the case of credit claims, right to collect the proceeds thereof until further notice, shall not prejudice the financial collateral having been provided to the collateral taker as mentioned in this Directive.

On this definition, financial collateral is 'provided' when the collateral taker has 'possession' or 'control' of the collateral. The questions in the chapter are: what amounts to possession or control? Do those terms mean the same thing or are they to be treated as separate concepts? In answering these questions, it is important to note the aim is to ascertain a system-neutral meaning of the phrase. Therefore, any definition must be independent of any doctrinal commitments, but must be based on effects which are similar. As noted in chapter one, the objective is to test the assumption of the functional theory, that legal rules can be defined without any attachment to a national context.

The Collateral Directive does not provide an answer regarding the meaning of the phrase 'possession or control'. However, three cases have provided various interpretations. Two of the cases were decided by the English courts (i.e. *Gray v G-T-P Group Ltd* [850] and *Re Lehman Brothers International (Europe) (in Administration)*[851] and the third is a case decided by the Court of Justice of the European Union (CJEU), *Private Equity Insurance Group SIA v Swedbank AS* .[852] In all three cases, the courts were concerned, *inter alia*, with the meaning of 'possession' or 'control' with reference to the usage of the term under the Directive, although

[850] *Gray v GTP* (n 755).
[851] *Lehman* (n 517).
[852] *Private Equity* (n 21) 207–239.

the English authorities were primarily focused on the UK Implementing Regulations, but made pronouncements on the meaning of the phrase under the Directive.

In *Gray*, the court held that the requirement of 'possession' is unknown to pure intangibles in English law, and instead that the relevant question was whether the collateral taker had 'control'. The court then defined control in terms of 'negative control', i.e. the right of the collateral taker to prevent the collateral provider from dealing with the collateral. In *Lehman,* the court disagreed with *Gray* on the issue that the concept of possession cannot be applied to intangibles. The court held that a restrictive view ought not to be taken and that it will be wrong to exclude any application of the concept of possession to intangibles. However, the court agreed with the overall conclusion in *Gray*: that the 'provision' requirement in the Directive is satisfied where the collateral taker can prevent the collateral provider from dealing with the collateral. In *SwedBank,* the CJEU did not explicitly consider whether the terms 'possession' or control' are separate concepts. However, the decision of the court suggests that the concepts indeed mean the same thing.[853] The court, though not directly referring to the English courts, arrived at a similar conclusion with the English court, that is, that the *provision* requirement is satisfied where the collateral provider is prevented from disposing the collateral.

The question in this section is whether the definition by the courts are indeed system-neutral.

10.2 POSSESSION AND CONTROL AS PUBLICITY REQUIREMENTS IN THE DIRECTIVE?

Before proceeding with the above question, it is important to consider the reason for the possession and control requirement in the Directive. This informs the later discussion on what the requirements mean and the rationale behind the court decisions in the three cases above.

As discussed in chapter one, the motive behind the Directive is to reduce the formalities required in relation to financial collateral arrangements. For this reason, the Directive required Member States to disapply some formal acts pertaining to the creation, validity, perfection and enforcement of financial collateral arrangements. However, while the Directive disapplies these formal acts, especially the requirements on registration, the Directive acknowledges that a balance need to be struck between market efficiency and the safety of the parties to the arrangement and third parties, for the reason of avoiding, *inter alia*, the risk of fraud. To achieve this balance, the Directive, in Recital 9, provides that

[853] See the recent analysis of the CJEU's decision in Gullifer, *Goode and Gullifer* (n 275) para 6.43.

> [T]he only perfection requirement which national law may impose should be that the financial collateral is delivered, transferred, held registered or otherwise designated so as to be in the possession or under the control of the collateral taker or of a person acting on the collateral taker's behalf.

It is apparent from the drafting above that the possession or control requirement is a 'perfection' purpose. The question is: what is perfection? Generally, the term 'perfection' is derived from Article 9 of the US Uniform Commercial Code.[854] However, it has found appeal in other systems such as English law and the EU. [855] The EC defines it as any step to be followed by a creditor designed to make the creditor's right effective in the event of insolvency of the debtor.[856] According to Gullifer, perfection requirements are legal steps required by law and designed to bring a security interest to the notice of third parties.[857] This will normally refer to registration or delivery of tangible assets. The EC notes that the requirement exists for several reasons: it ensures that the creditor does not illegally benefit from the collateral and that the collateral provider is prevented from further using the collateral. The EC also notes that the requirement gives awareness that the collaterals are not available in an insolvency situation. [858]

The most important method of perfection is registration. [859] However, this may be dispensed with, according to Gullifer, where there are other means: for example, where the secured creditor has possession or control of the asset or because of some other policy reasons.

The concept of perfection is associated with publicity and the different forms of publicity (i.e. registration, possession) which makes a security right enforceable against third parties. As noted in section 4.2, failure to comply with this requirement will normally render unenforceable the security right against third parties. The question is whether the possession or control requirement in the Directive indeed performs a publicity function based on the drafting of the Directive?

Gullifer argues that it does.[860] According to her, the possession or control requirement helps to provide safety against the risk of 'invisibility' which may arise as a result of the disapplication of the registration requirement in the Directive. She suggests that the provision is an alternative perfection requirement which provides safety against fraud by the collateral

[854] Beale and others (n 279) para 9.02.
[855] ibid 9; Gullifer, *Goode and Gullifer* (n 275) ch 2. See also EC, 'FAQ', 2.
[856] EC, 'FAQ', 2. Beale and others (n 282) para 9.01.
[857] Gullifer, *Goode and Gullifer* (n 275) para 2.16.
[858] EC, 'FAQ', 2.
[859] Gullifer, *Goode and Gullifer* (n 275) para 2.16.
[860] ibid 6.41.

provider who may grant a security right to a third party without disclosing the previous interest. It also helps to provide publicity against the risk of the collateral taker declaring that there is a security right when there is none, or denying the existence of a security right that was granted.

The idea that the possession and control requirement is a publicity requirement is shared by Beale. He argues that the provision results in the security right becoming obvious to third parties, [861] and 'discoverable by at least potential subsequent secured parties or buyers of the collateral'.[862]

The method of transacting securities in the financial market makes it questionable whether the possession or control requirement indeed performs a publicity function. As noted in sections 5.3.2, there has been a shift of securities holding from a materialised system to dematerialised system. This shift has also brought about operational changes on how securities are transacted. Transactions are carried out electronically mainly through authorised persons, through debit or credit entries in a way similar to bank transfers.[863] Third parties may therefore have no access to securities account without the authorisation of approved persons. The question therefore arises as to whether the possession or control requirement indeed performs a publicity function.

Beale recognises the inadequacy of the requirement in the Directive and notes that one problem with the requirement is that unsecured creditors and similar enquirers not discover the security right. However, he concludes that regardless of this difficulty, the requirement is a policy decision in the Directive which subordinated the 'principle of warning unsecured creditors' to the needs of the financial markets.[864]

Zaccaria has equally argued that the appropriate way to explain the requirement in the Directive is to consider it as a form of perfection requirement that does not y involve the same level of publicity. She argues that although perfection is generally intended to provide notice to third parties, this does not refer to the world at large, but to parties who have access to the financial markets or access to the information concerning the security arrangement.[865] Her argument therefore suggests that although real rights have a third-party effect, this ought to be restricted to only a limited number of parties that can access the security right because of their participation in the market. However, the question is: how about parties who cannot access the

[861] Beale and others (n 279) para 9.13.
[862] ibid.
[863] Elena Zaccaria, 'An Inquiry into the Meaning of Possession and Control over Financial Assets and the Effects on Third Parties' (2018) 18 Journal of Corporate Law 217, 242.
[864] Beale and others (n 279) 9.13.
[865] Zaccaria (n 863) 243–244.

information, but who, in some ways, are connected to the debtor? This may be other creditors of the debtor. Does it mean they are not bound by the security right?

According to Sjef van Erp: 'If third parties are to be bound by a right the creation of which happened without their consent, they must at least be able to gather information on such right'.[866] Therefore restricting their access to such information may not only violate their right of freedom and equality,[867] but it also means they cannot be bound by such right. In other words, such rights cannot be enforceable against them. Importantly, the restrictive access to such right raises questions whether it is transparent enough to constitute a property right which has a wider, exclusionary effect on an unidentifiable range of persons.

The above suggests that it is controversial if the possession or control requirement in the Directive is adequate as a publicity requirement. However, regardless of this, two conclusions can be drawn; first, it may be said that notwithstanding the inadequacy of the requirement as a publicity requirement, it is clearly the policy of the Directive to treat it as a publicity requirement. Therefore, it is inconsequential if it is not transparent; the publicity principle is generally a matter of policy, even if restrictive. If this is a policy choice, it is therefore not totally different from what can be found in a sale contract under the Sale of Goods Act, where ownership may pass by a mere agreement without an external act even though the real rights in the goods may affect third parties who are not aware of the right. Essentially, what this means is that although it is generally desirable to publicise real rights, the motivation is not always even, depending normally on policy choices. In this context, although the possession or control requirement in the Directive may be dependent on the security arrangement, this does not matter for the purpose of enforceability of the real right.

Another conclusion, which appears to be more plausible and which finds some support in the three judicial authorities below, is that the possession and control requirement is not a publicity requirement. Instead it is a requirement which imposes a duty on the collateral provider, who creates a security right, to yield up control of the asset in other to gauge its willingness to enter into the transaction. In this regard, the collateral provider cannot have, at the same time, both the benefits of creating a security right as well as control of the assets which it can freely deal with. This amounts to it having the best of both worlds. Because a security right has a third-party effect, the expectation is that the collateral provider should be able to

[866] Sjef van Erp, 'From "Classical" to Modern European Property Law?' in A Sakkoulas and E Bruylant (eds), *Essays in honour of Konstantinos D. Kerameus: Festschrift für Konstantinos D. Kerameu*, vol 1 (Bruylant 2009) Also available: <https://ssrn.com/abstract=1372166> accessed 30 September 2018, p 10.
[867] ibid 10.

give up something in return. Where it has the control of the collateral, this makes it somewhat loose for it to create further security rights on the collateral thereby jeopardising other third parties. Secondly, and related to this, yielding control of the assets may also prevent unauthorised disposition, since it provides a safety valve against further dealing in the collateral by the collateral provider.

The question is: how does the above argument protect the parties and third parties against the risk of fraud contained in Recital 10 of the Directive? In relation to third parties, fraud may arise in different situations. It may arise where the collateral provider falsely misrepresents the collateral asset as unencumbered. It may also arise from fraudulent antedating of the security agreement in favour of the collateral taker in the event of insolvency, to take it out of the insolvency protection date. It may be said that yielding up possession or control of the asset may deal with these two risks. First, where an arrangement, while it is still ongoing, is very loose as to how the assets are dealt with by the collateral provider, there is little preventing the parties from carrying out the activities, such as antedating, which are adverse to third parties including the insolvency administrator. Therefore, the control or possession requirement acts as a safety valve against the risk of slack dealing in the collateral, to avoid it affecting third parties. A collateral provider who has been dealing with the assets may be estopped from presenting a security document to show it lacks control. This is because the transaction will constitute a sham and will be void.

Additionally, the risk between the parties, i.e. that no collateral arrangement was created, may be dealt with where the collateral provider is required to yield up control in exchange for the security right. Where the collateral provider is dispossessed, this raises the presumption of a property right in the collateral. In this regard, a likely objection may be that the presumption raised is tantamount to publicity function . However, it may be said that a distinction need be made between a presumption which is between the parties in dispute, rebuttable by proof of the security arrangement, and a presumption which acts in the form of publicity to the whole world. The presumption which arises here, by the yielding up the collateral, is one between the parties in dispute which may be established by discharging the evidential burden of proof through the security arrangement.

In contrast to the publicity argument above, the above analysis may provide a plausible justification for the possession or control requirement in the Directive. As noted, one objection to the publicity analysis is that it is difficult for third parties to discover the security right. This is because the security arrangement is discoverable by a limited class of persons that have access to the contractual positions between the parties. As noted, this renders the publicity argument in

favour of the requirement very questionable. However, we can explain this limited access if it is accepted, as argued, that the requirement is meant to ensure that the collateral provider is persuaded to yield up something valuable in return for creating a right which is detrimental to third parties. This argument therefore rightly restricts the consideration to the contractual position between the parties, rather than on the transparency of the right to third parties. As will be seen in the cases below, this alternative analysis finds support in the conclusion of the courts below, who focused on whether the collateral provider was sufficiently dispossessed, rather than whether dispossession was adequate to publicise the security rights.

10.3 NEGATIVE CONTROL AS SYSTEM-NEUTRAL MEANING

The discussion above considers the purpose of the possession or control requirement. However, it is still unclear what those terms mean. The aim is to identify a system-neutral meaning of the term. In considering this question, references will often be made to the control requirement for fixed and floating charges in English law: this is because they constitute the equivalent institutions in regard to which the control requirement in the Directive arises.

Three cases explain the possession or control requirement in the Directive. The cases provide explanations on, first, whether the terms 'possession' or 'control' can be used conjunctively; and, secondly, what both concepts mean in terms of their effects. The first two decisions below are first instance decisions in the UK pertaining to the English law floating charge. The last is a decision of the Court of Justice of the European Union (CJEU) which appears to tacitly endorse the UK decisions. Although the UK decisions were primarily concerned with the UK implementing Regulations, they made pronouncements on the meaning of the phrase 'possession' or 'control' in the Directive. As noted in chapter three, Directives are directives to Member State to implement specific results. They therefore do not have a direct impact. Ideally a national court called to interpret the effects of directives ought to start off with its own national legislation, except where, as noted in chapter three, the directive has not been properly implemented. As will be seen below, in the two UK cases, the courts' direct reference to the Directive may have been justified because the implementing regulations seemed not to have been properly implemented.

Also, in *Lehman*, Briggs J extensively referred to the *travaux preparatoires* of the Directive to investigate the history and proper meaning of the possession or control requirement in the Directive, to arrive at the right interpretation. As will be seen below, although reference may be made directly to the Directive where the implementing legislations is unclear, nothing

stops the national court, as Lord Reed and Prechal suggests in section 3.3, from applying local concepts to implement the results set by the Directive.[868]

It is in light of the foregoing that the pronouncements of the court in both *Gray* and *Lehman* can be said to be useful in considering the meaning of the concepts of possession or control at the level of the Directive and whether a system-neutral meaning can be identified.[869]

10.3.1 *Gray v GTP Group:* 'Control' *alone* as negative control

In *Gray v G-T-P Group Ltd*, F2G was a retailer of laminated floors while GTP supplied debit card services to F2G. The sums paid by F2G'S customers using the debit cards were paid into a bank account maintained by GTP. The parties executed a declaration of trust under which GTP was appointed as trustee for F2G (as beneficiary). The trust declaration provided ways in which the sums in the account were to be dealt with. GTP held the balances in the account for the benefit of F2G who could empty the account. Clause 3 of the declaration provided that GTP could withdraw from the account such sums as were due to it from F2G in some situations, such as where F2G was in breach of the agreement or where payment due to GTP was overdue for 14 days or if F2G became insolvent. The declaration was not registered. Few years later, F2G went into liquidation. GTP sought to set off against the balances sums for operating fees and some other claims from F2G. The administrators/liquidators applied for a pronouncement that the trust declaration in relation to the bank account was as an unregistered floating charge on F2G'S property and thus void against them.

The courts considered three issues in the case. The first was the nature of rights created by the parties; secondly, what was the correct legal characterisation which may be used to identify the rights and obligations; and third, did the arrangements constitute an SFCA under the UK Implementing Regulations to exempt it from the registration requirements? Although the first two issues do not touch directly on the meaning of possession or control in the Directive, they provide hints on the factors which influenced the court in arriving at the decision, and are also important for the argument to be made later against authors who argue that the control requirement in English law is not the same as that in the Directive.

[868] Lord Reed (n 203) 171–172.

[869] For *Gray v GTP* (n 755) paras 61–62 where the court held: '[I]t is relatively clear from the usage in the Directive that it is talking about a situation in which the legal right to the charged asset is removed from the collateral provider''.' See *Lehman* (n 517) para 131 where the court noted: 'The next stage therefore is to focus upon precisely what is required by the whole of Article 2.2 [of the Directive]' and then went ahead to interpret the provision.

It is important to note that at the time of the decision in *Gray*, the UK implementing Regulations had not been amended to include a definition of possession.[870] Therefore, Vos J, in arriving at the decision below, bemoaned the lack of authority on the meaning of the phrase. Because of this, the Judge noted that that he had no option but to refer to the provisions of the Directive as the primary legislation. It was therefore within this context that he sought to find an autonomous meaning of the phrase, taking account the Directive.

In determining the first question above, Vos J adopted the two-step approach propounded by Lord Millett in *Agnew v Commissioner of Inland Rev*.[871] First, he observed that the declaration of trust was to be construed to distil the intentions of the parties based on the language used, to identify the rights and obligations. This was not a question of law. The second step was to decide the correct legal categorisation into which the rights and obligations fell. This was a matter of law and does not depend on the intention of the parties. In this regard, Vos J held that the fact that cl 3 only bites when there is one of the listed events of default defines the relationship between the parties. Vos J was of the view that the effect of cl 3 was to secure the sums that may in the future become due to GTP from F2G. As such, it was a charge on the assets.

After addressing the first issue above, Vos J considered the second question, which was the correct legal characterisation to be ascribed to the transaction; that is, whether the charge was fixed or floating. Applying the test in *Re Spectrum Plus Ltd*,[872] Vos J concluded that the charge was a floating charge. He held that the element in determining the difference between a fixed and floating charge is the chargor's ability without the chargee's consent to control and manage the charged assets. Vos J noted that although the money could be moved out of the account with GTP taking some administrative step to transfer the money to F2G, GTP had no right to use the money for any purpose but to make the transfer to F2G when it was asked to do so. In making the transfer, GTP was merely acting purely in an administrative capacity. Vos J also held that based on *Re Spectrum Plus Ltd*, the degree of control required to sustain a fixed charge meant that the account in the instant case ought to have been a blocked account. However, since until an event of default occurred, GTP had no right to prevent F2G from

[870] However, the implementing Regulation was amended sequel to the decision in *Gray* to include a definition of 'possession'. The amendment was made following a critique of Vos J's decision by the Financial Market Law Committee, that the decision had the effect of removing large swarths of transactions from the scope of the Directive and constituted an 'unwelcome precedent'. The FMLC proposed a definition of 'possession' which was substantially included in the amended Regulations. See Financial Market Law Committee (FMLC), *Control: Gray v G-T-P* (December 20i0) Issue 18, available at http://fmlc.org/wp-content/uploads/2018/02/Issue-87-Control-Gray.pdf (assessed 22 April 2018).
[871] [2001] UKPC 28.
[872] [2005] UKHL 41.

exhausting and emptying the account or to prevent him from requiring payment to it of the entire sums. He concluded that the account was not blocked and as such the charge was a floating charge.

The next question was whether the purported trust was an SFCA and subject to the protection of the FCAR. In determining the question, Vos J noted that for an arrangement to come within the scope of the FCAR and Directive, the financial collateral must be in the possession or under the control of the collateral taker. He noted that although the meaning of those terms is not spelt out in the Directive, any meaning to be ascribed must be devoid of any reference to national law.[873] However, immediately upon making this statement, Vos J seemed to have taken a contrary approach in relation to the application of the concept of possession to intangible property. In this regard, Vos J pointed out that 'since in English law possession has no meaning in relation to intangible property, it may be the meaning of control that is critical'.[874] Therefore, in his view, the relevant question was whether GTP had control over the money in the account. In relation to this question, he accepted the analysis proffered by Beale *et al* [875] who distinguished between positive control, negative control, administrative control, and legal control. On one hand, positive control is the collateral taker's ability to remove the asset from the collateral pool without any further involvement of the collateral taker. On the other hand, negative control is the collateral taker's ability to prevent the collateral provider from dealing with the asset. Positive and negative control may also be legal or administrative (operational). Legal control is the legal right of the collateral taker to remove or prevent the removal of the assets; operational control is the practical ability of the collateral taker to remove or prevent removal of the account balances. Vos J held that for a collateral arrangement to fall within the requirements of Article 2(2) of the Directive, the collateral taker must have at least negative control to prevent the collateral provider from disposing the asset. He reasoned, in line with the analysis of Beale *et al*, that the provisions of the Directive provide hints that point towards negative control as the appropriate interpretation.[876] The first is the second paragraph in Article 2(2) of the Directive which provides that the right of substitution or withdrawal of excess collateral by the collateral provider shall not prejudice the collateral taker from having control. Vos J held that this paragraph would not be necessary if control only meant

[873] *Gray v GTP* (n 755) para 48.
[874] ibid.
[875] Beale and others (n 279) ch 3 (the court referred to the 2007 edition).
[876] *Gray v GTP* (n 755) paras 59–62.

administrative control.[877] In other words, the paragraph will be redundant if the collateral provider could withdraw the entirety of the collateral as of legal right since the collateral taker could not prevent it as of legal right to deal with the asset. Secondly, Vos J also held that Recital 10 in the Directive makes it clear that the Directive only covers collateral arrangements which provide for some form of 'dispossession'. Vos J held that although dispossession is a difficult term in English law,[878] the term is suggestive of a situation where the legal right to the charged assets are removed from the collateral provider. If the collateral provider can deal with the assets, it therefore means that it was not dispossessed. Thirdly, Vos J also accepted Beale *et al* analysis that control in the Directive referred to negative control in the sense that the collateral take can prevent the collateral provider from dealing with the assets. If the collateral taker cannot prevent the collateral provider from dealing with the charged assets, then he does not have control. He may have control only in the administrative sense, as in the instant case, where GTP could practically administer the account but was bound to act under the instructions of the collateral provider. In conclusion, Vos J held that the floating charge could not receive protection under the FCAR as it could not be concluded that the GTP had control of the charged asset.[879]

Some observations may be made in relation to the above decisions: first, Gullifer notes that if the concern of the Directive is invisibility, then practical control rather than negative (legal) control ought to be sufficient, since it gives rise to outward signs rather than been dependent on the contractual position between the parties.[880] In essence, because GTP had practical control in the instant case (because it administered the account on behalf of F2G), practical control ought to have been adequate if the concern was with invisibility. However, the court thought otherwise, as it was merely focused on whether F2G could deal with the collateral. Essentially, this supports the argument made earlier that the possession or control requirement is not a publicity requirement. Its purpose is to require the collateral provider to yield up the assets in other to measure its readiness to enter into the transaction. If the concern

[877] Administrative control suggests that the collateral taker has just the practical, rather than the legal, means to prevent the collateral provider to deal with the collateral. Where the collateral taker has only practical control, he may be in breach of the security arrangement where it deals with the collateral without legal control.
[878] Though he does not state this expressly, but the suggestion is that he made this comment in view of his earlier comment that the concept of possession is inapplicable to intangible property. Dispossession will be an 'obverse' of possession. *Lehman* (n 517) para 114.
[879] *Gray v GTP* (n 755) para 60.
[880] Gullifer, *Goode and Gullifer* (n 275) para 6.43.

was publicity, Vos J may have been more persuaded by the practical control exercised by the collateral taker, as Gullifer notes above.

The second observation is this: Vos J was clear that 'it will not be right to construe [the Directive] according to English law principles or to understand it as being specifically and only applicable to any one national law'.[881] By this statement he acknowledged the need to take a system-neutral approach to the interpretation of the possession and control requirements in the Directive. However, he took a contrary approach, as he held that in English law, the concept of possession was not applicable to intangibles. It has been argued that by taking this approach, Vos J failed to adopt a method which he himself advocated for by interpreting the concept of possession in a doctrinal way.[882] The argument in section 3.3 implies that Vos J's position is right if it is taken that the court's duty, based on Lord Reed's suggestion,[883] is to identify the broader standards set out in the Directive and then to apply relevant local concepts to arrive at a result which is in compliance with that standard. In essence, it may be said that nothing stops the national courts from interpreting the standards in the Directive with the aid of legal concepts familiar to their own system. Likewise, national courts may conversely refuse to apply local concepts in applying the Directive when, in the court's view, such a concept does not help in the achievement of the broader principles set-out in the Directive. However, as the above view suggests, before applying local concept, it is important to first ascertain the broader principles enunciated by the Directive, before either applying or not applying local concepts in the achievement of a result. In this regard, Vos J was probably quick to arrive at a decision on the concept of possession. He ought to have considered the broader functional results in the Directive and whether the English law concept of possession helps to achieve the results in the Directive, before holding that possession is unknown to intangibles.

The above observation likewise applies particularly to Vos J's application of the fixed/floating charge control test to the possession and control requirements in the Directive. It is important to note that in interpreting the meaning of the term 'dispossession', Vos J referred to the control requirement in a floating charge to conclude that there was no

[881] *Gray v GTP* (n 755) para 57.
[882] In other words, he failed to adopt a method which he himself had acknowledged ought to be taken: Robin Parsons, 'Financial Collateral – An Opportunity Missed' (2011) 5 Law & Fin Mar Rev 164, 167.See also Financial Market Law Committee (FMLC), Control: Gray v G-T-P (December 2010) Issue 18, available at http://fmlc.org/wp-content/uploads/2018/02/Issue-87-Control-Gray.pdf (assessed 22 April 2018).
[883] Lord Reed (n 203) 171–172; *Cukurova Finance International Ltd v Alfa Telecom Turkey Ltd* [2009] UKPC 19 [32].

dispossession because GTP did not have the legal right to use the money.[884] In other words, because F2G could still deal with the assets, it had control and could not be said to have been dispossessed. Vos J also expressed some scepticism on whether 'the Directive should automatically apply to any floating charge as that term is understand under English law'.[885] It was his view that regardless of the fact that the implementing Regulations referred to a floating charge in the definition of a security interest, this did not mean that a floating charge fell within the scope of the Directive. Primarily, because the Directive requires the collateral taker to have control, it was questionable if a floating charge could so qualify since the chargee (collateral taker) normally lacks control. Essentially, this interpretation suggests that the control requirement by the court may have been influenced by the control requirement used to distinguish a fixed and floating charge. However, as already mentioned, the application of local concepts by the national courts may be justified where the application of such concept helps in achieving the target set out by the Directive. Thus, it is not problematic if the court applied the control test for a fixed charge in achieving the result set out by the Directive.

10.3.2 *Re Lehman*: 'possession' or 'control' as both giving rise to control

In *Re Lehman Brothers International (Europe) (in Administration),* the court interpreted the possession and control requirement to mean negative control, in line with *Gray v G-T-P*. However, the judge rejected Vos J's position that possession of intangibles was not recognised in English law.

Before examining the case, it is important to note that following *Gray's* decision, the HM Treasury, on the advice of the Financial Market Law Committee,[886] amended the UK Implementing Regulations to include a definition of possession.[887] The amendment was not applied by Briggs J because it came in 2010 after the transaction between the parties had been executed.[888] Applying it would have had a retrospective effect. However, Briggs J opined that the amendment was 'immaterial' and 'largely theoretical',[889] although he noted that it may have

[884] *Gray v GTP* (n 755) para 61.
[885] ibid 58.
[886] *Lehman* (n 517) para 126.
[887] There was no definition of control, as it was thought that possession included some elements of control. This was based on the advice of FMLC. The amended regulations defined possession as arising 'where financial collateral has been credited to an account in the name of the collateral-taker or a person acting on his behalf […] provided that any rights the collateral-provider may have in relation to that financial collateral are limited to the right to substitute financial collateral of the same or greater value or to withdraw excess financial collateral'.
[888] *Lehman* (n 517) para 25. The Master Custody Agreement was documented in 2003, although the parties had been dealing with each other before then. The documentation followed a regulatory change by the Taiwanese authorities.
[889] ibid 126.

been useful within the context of applying the Directive within English law. [890] Briggs J then went on to consider, in extensive detail, the provisions of the Directive, as well as *travaux preparatoires* to the Directive to identify the proper meaning of the concepts in the Directive. It may be thought that his direct interpretation of the Directive was partly based on his view that the Regulations did not properly implement the Directive. In any event, his pronouncement on the Directive is vital to understand the meaning of the phrase at the level of the Directive.

In that case, the administrator of Lehman Brothers International (Europe) (LBIE) sought the court's directions on the security provisions in a Master Custody Agreement (MCA) which was executed between Lehman Brother Finance SA (LBF) and LBIE. The MCA supposedly created a 'general lien' for the benefit of LBIE not only for debts owned by LBF to LBIE, but also for other debts owed by LBF to affiliates of LBIE. The general lien covered securities held by LBIE under the MCA. As a client, LBF was at liberty to demand a withdrawal of all or part of the property in the custody account. However, by clause 13 of the MCA, LBIE could withhold some property where there were grounds to think that the property was not adequate to cover LBIE's exposure to LBE.

Applying the case of *Re Spectrum Plus Ltd,* Briggs J found that the 'general lien' amounted to a floating charge to secure the LBF's liabilities to LBIE because LBF retained, pending crystallisation, uncontrolled right of recall and disposal of the property held in custody; it could do whatsoever it liked with the asset. The court then considered whether LBIE had possession or control over the securities in the MCA to bring it within the protection of the FCAR. In this regard, the court also held that the distribution of the parties right in the MCA was such that, as mentioned, LBF could deal uncontrollably with the property to an extent substantially greater than right of substitution or withdrawal of excess. This therefore meant that LBIE had no possession or control.[891]

[890] His objection was that the amendment gave with 'one hand but took as much with the other' in the sense that it provided a definition of possession, but 'limited' the right which the collateral provider may have in the collateral to only a right to substitute or withdraw excess collateral. The Directive, on the other hand, suggests that the collateral provider may, in addition to this right, have other rights.

Secondly, although not explicitly stated by Briggs J, his analysis, as will be seen below, suggests a rejection of the definition in the amended Regulations. As noted, the amended Regulations seem to suggest that operational control is enough (i.e. financial collateral credited into an account), but Briggs J rejected this in his judgment, which will be examined below. This indicates, as earlier argued, that the possession and control requirement is not a publicity requirement.

[891] *Lehman* (n 517) para 147.

In determining the question whether LBIE had possession or control, Briggs J confirmed the need to take a system-neutral approach. He pointed out that the interpretation to be given to Article 2.2 of the Directive must be purposive, and that the purpose can be identified from the second half of Recital 10 which provides that the balance between market efficiency and creditor protection is to be struck by limiting the scope of the Directive to collateral arrangements which provide for some form of *dispossession*. Referring to Article 2.2, the judge observed that the phrase 'so as to be in possession or under the control of the collateral taker' cannot merely be a description of the invariable consequences of the collateral being delivered, transferred, held, registered or designated. The judge observed that on the contrary, the phrase 'so as' may be better understood to mean 'in such a way that'. In other words, the 'so as' is not a consequence of the transfer, delivery, or designation, etc; it is merely a requirement.[892]

The question, then, according to the judge, is what is required by Article 2.2 to fall within that the phrase 'in a such a way that'. That is, how do we get the consequence (possession or control) from the requirements (transfer, delivery, designation, etc). First, the judge held that contrary to the decision of Vos J in *Gray v G-T-P*, it is wrong to limit the concept of possession to only tangibles, since the Directive ought to be interpreted without reference to national legal systems. In this regard, the judge held that Article 2.2 clearly contemplates that a particular form of delivery, transfer, holding, registration or designation may be sufficient to establish possession but not control, or control but not possession, but that in either case the requirement of Article 2.2 would be satisfied. This suggests that the two concepts are different but that they functionally give rise to the same effects, which, according to Briggs J, will satisfy the possession or control requirement in the Directive. What draws both concepts together, according to Briggs J, is the idea of control. The judge noted that 'control (whether legal or administrative, negative or positive) lies at the heart of the concept of possession or control'.[893] Thus, it is easy, based on this, to arrive at a conflated meaning of both terms.

The judge further observed that what needs to be shown to bring an arrangement within the possession or control requirement in Article 2.2 is that the terms upon which the collateral is provided are such that there is shown to be sufficient possession or control in the hands of the collateral taker for it to be proper to say that the collateral provider is dispossessed. In other words, the collateral taker ought to have legal, rather than the administrative, control to prevent the collateral provider from dealing with the asset. It is only when this is possible that there can

[892] ibid 129.
[893] ibid 131.

be *dispossession*. Essentially, Brigg J's conclusion broadly agrees with the decision of Vos J, save for his (Vos J) approach which restricts possession to only tangibles.

The above analysis focuses on the right of the collateral provider rather than the right of the collateral taker in the collateral. The reason for this, according to Brigg J, is that the Directive provides that the balance to be struck between market efficiency and safety of the parties can only be achieved by the Directive applying to only financial collateral which is capable of being dispossessed. Therefore, dispossession which, according to Briggs J, is the 'obverse' of possession and control is the key factor.[894] Consequently, in determining whether the possession or control requirement has been satisfied, the single question is whether the collateral provider has been dispossessed (i.e. does the collateral taker have the legal right to prevent him from dealing with the collateral). As hinted, Briggs J is able to arrive at this unitary meaning because of his view that control lies at the heart of both the concept of possession and control.

Briggs J acknowledged that one likely objection may be the appropriateness of applying English law tests on control to the Directive, as was done in *Gray v GTP*. However, he said he was 'less persuaded' by that objection.[895] In his view, he saw no reason why English law techniques for determining control may be less available to the court when analysing the same question in the Regulations which implement an EU-wide scheme. This observation acknowledges the fact that the meaning ascribed to the control requirements in the Directive may have been influenced by the meaning of that term in English law, raising questions whether that term is system-neutral.

Three issues may be highlighted in relation to the above decision: first, in contrast to the method adopted by Vos J in *Gray*, Briggs J first start off by identifying the standards set by the Directive in line with Article 2.2. It was after he was able to sketch an autonomous, system-neutral meaning that he proceeded to interpret the effects of both concept of possession and control. Essentially, contrary to the careful approach shown by him in acknowledging potential objections to his methods of applying local concept, this was the right approach to adopt, since, as discussed in chapter three, directives are to be implemented with the aid of local concepts.

Secondly, as already mentioned, Briggs J seems on one hand to treat possession and control as different concepts, but on the other hand seemed to have conflated their effects. [896]

[894] ibid 107,114,119,130.
[895] ibid 152.
[896] Yeowart and others (n 252) paras 8.73-8.76; see also Madeleine Yates and Gerald Montagu, *The Law of Global Custody* (4th edn, Bloomsbury Professional 2013) para 4.103.

If possession and control refer to the same thing (control), the implication is that the concept of possession is redundant, since the concept of control performs the function of both concepts. This outcome may imply that although both concepts may normally mean different things, as Briggs J suggests, the Directive uses them in a way which suggests that they refer to the same thing, i.e. control.

Thirdly, Brigg's J decision amounts to a functional interpretation of the possession or control requirement, since a technical interpretation of the term 'possession', as Vos J does, may yield an impossible outcome. It is important to note that Article 2.2 of the German and French versions of the Directive also contain the term 'possession' ('*Besitz'* and '*la possession'* respectively). The concept of possession is perhaps one of the most widely contested concepts in EU private law. The concept is normally defined as the 'situation in which it is not only possible for the possessor to affect a thing physically but also to prevent anyone else from affecting the thing in this way'.[897] Since possession presupposes physical control, it is conceived only with regard to corporeal things in many European countries, including English law, as Vos J highlighted.[898] Therefore interpreting the provisions of the Directive in line with how those concepts are to be understood doctrinally renders its implementation difficult. This can be prevented if, as already argued and as Briggs J seems to endorse, the Directive is seen as functional and setting system-neutral standards focusing on specific effects. The last point above endorses the arguments made in chapter three that the concepts in EU directives are not doctrinal concepts. They are to be treated functionally as autonomous, system-neutral concepts which do not reflect any national legal doctrine.

10.3.3 *SwedBank*: possession and control as negative control

The meaning of possession or control was also considered by the CJEU in *Private Equity Insurance Group SIA v Swedbank AS*.[899] The case was referred to the CJEU by the Supreme Court of Latvia. The facts are: a Latvian bank took a pledge over a Latvian company's current bank account to secure the debts owed by the company. The company was later declared insolvent, and the insolvency administrator entered into a new current account contract containing the same collateral conditions. The bank debited certain sums from the account as maintenance commission for the period up to the insolvency declaration. The insolvency

[897] Thomas Rüfner, 'Possession' in Florian Möslein and others (eds), *Max Planck Encyclopaedia of European Private Law* (Oxford University Press 2012) 1293.
[898] ibid; see also AFJ Thibault, *System Des Pandekten-Rechts* (1st edn, 1803) §269; FK von Savigny, *Treatise on Possession, or, The Jus Possessionis of the Civil Law* (E Perry tr, 6th edn, 1837) 131. Citations are obtained from Alasdair Peterson, 'The Positive Prescription of Servitudes in Scots Law' (PhD, University of Edinburgh 2017) 94–99.
[899] *Private Equity* (n 21).

administrator brought an action against the bank for recovery of the amount, invoking the principle of equal treatment of creditors. Observations were submitted by the parties, including *inter alia* the UK Government, although the contents of the observations were not discussed in the judgment. The CJEU held that the taker of collateral in the form of monies lodged in an ordinary bank account may be regarded as having acquired possession or control of the moneys only if the collateral provider is prevented from disposing of them. The CJEU did not, however, make a pronouncement on the effect of this provision on the facts of the case as there was no evidence before the court that the collateral provider had the right to deal with the collateral. The court referred the case back to the Latvian court to make a finding on that issue.

10.4 Control in Directive equivalent with English law Fixed and Floating charge Control?

Importantly, the interpretation in *SwedBank* of the possession or control requirement seems similar to the decision in *Grey* and *Re Lehman Brother International*. In fact, recent analysis of the CJEU decision from the English law perspective, note that the CJEU decision 'followed [the] two decisions' above.[900] This suggests that the decision tallies with the decisions in the two English cases. Although the CJEU did not explicitly refer to the two UK decisions, it is important to note that the Advocate General (AG) in his opinion referred to the two English cases. In the AG's view 'the consideration which led the UK courts to reject the argument that mere administrative control exercised over the object of the collateral is sufficient are also relevant to the interpretation of Art 2(2) of the Directive in [the] case'.[901] The AG was of the view that the UK courts rightly stated the position by holding that possession or control will be ineffective if the collateral provider is able to continue to dispose the collateral freely.

It will seem that both the AG and the CJEU were aware of the two UK decisions, though, as noted, the CJEU did not make a direct reference to the UK decisions. While the AG explicitly approved the UK decision, the CJEU did not express any criticism of the two English cases. This implies some tacit endorsement of the decisions, which may matter in terms of the methodology present in the case.

First, regarding Vos J's pronouncement that the concept of possession was inapplicable to intangibles in English law, CJEU may have tacitly endorsed the view that no meaningful content could accurately be given to the concept under English law. If this is the case, the effect of this may be to render meaningless the objective of the Directive which sets standards and

[900] Gullifer, *Goode and Gullifer* (n 275) para 6.42; Beale and others (n 279) para 3.100 who make this suggestion although referring to the opinion of the AG.
[901] *Private Equity* (n 21) 220, see paras 48-49 for AG's opinion.

broad principles that national legal concepts are meant to implement. National concepts are to implement the Directive through functionally equivalent institutions. Essentially, if the concept of possession was to be defined in a technical way it becomes highly problematic for national systems to implement it, since many EU systems, as earlier noted, rarely recognise the possession of intangibles. On the other hand, it may be said that the CJEU could not have endorsed Vos J's decision because the CJEU seemed to have defined both concept of 'possession or control' as giving rise to the same requirement (i.e. ability to prevent the collateral provider from dealing with the collateral). Essentially, this draw the decision more toward the decision of Briggs J.

Secondly, the CJEU interpretation mirrors the two English decisions in terms of the control requirements. Arguably, this may a tacit acknowledgement that the possession or control requirement in the Directive closely imitates the English law fixed and floating charge control requirements and therefore should be interpreted to align with it. Adopting this position hides some assumptions: First, the approach adopted by the English courts in the two cases above, and arguably the CJEU, reflects the inductive approach of English law to characterisation: it starts off investigating the rights and obligations and then tries to identify the legal effects of the transaction. This approach contrasts with the deductive approach in Civil law which starts off from a general concept, with the assumption that the concepts, when adopted, perform the functions so desired. [902]

Both *Gray* and *Lehman* adopt this approach, which seems to feed into the decision of the CJEU above. They start off by considering the rights and obligations under the security arrangements and then made a decision on the legal effects of the transaction. The many debates about negative or positive control, administrative or legal control arise from this approach, as these normally are premised on an interpretation of the contractual position between the parties, as noted by Gullifer above.[903]

Furthermore, whereas in English law, much about fixed charges turn to whether the collateral taker has control and the collateral provider is prohibited from disposing of the securities, in Civil law systems, this is not important, as it is in the nature of security right that they are binding on successors and cannot be freely disposed.[904] In essence, the questions on control, and whether

[902] FH Lawson, *A Common Lawyer Looks at the Civil Law: Five Lectures Delivered at the University of Michigan* (University of Michigan Law School 1953) 66.
[903] Gullifer, *Goode and Gullifer* (n 275) 6.43.
[904] Ross Anderson, 'Security over Bank Accounts in Scots Law' (2010) 4 Law & Fin Mar Rev 594, 597.

the collateral taker has control or the types of control,[905] are all closely knitted into English law legal structure, particularly with reference to the fixed/floating charge distinction. Generally, under English law, questions about whether a charge is floating depends on whether there is, or there is no, control. It is not so much the absence of control that characterises a floating charge, but rather the presence of control which characterises a fixed charge. Therefore, questions about whether a charge is floating will often turn towards whether the chargee has control. This may be contrasted with Scots law, for instance, which recognises only the floating charge. In Scot law, it is either a party has a floating charge or there is no charge at all.[906] There is less emphasis on the control requirement.

As noted, the English law propensity to pay attention to the question of control feeds into the many debates in this section about control, the different types of control; is it negative or positive, or administrative or legal, etc. This is premised on the fixed/floating charge control test.[907] Therefore, if it is accepted that the CJEU decision closely mirrors the two English law decisions, it is questionable if its interpretation of the Directive is indeed system-neutral. Such an approach will defeat any aim towards the system-neutrality of the broader principles or targets in the Directive.

In summary, the argument above is that the interpretation of the possession or control requirement in the Directive closely reflects the control requirement distinguishing a fixed and floating charge in English law. This aligns with the argument made earlier that the possession or control requirement is not a perfection requirement. Rather, it performs two functions, one of which was seen earlier. The first function is that it is a priority requirement. Beale *et al* notes that a registered fixed charge takes priority over a registered floating charge.[908] This may be based on the fact that there is an 'implied authority' imposed on the debtor, under a floating charge, to continue to deal with the assets.[909] Therefore, a party who acquires the charged asset in the ordinary course of business has priority, even if it takes it with knowledge of the existence of the floating charge.[910] Essentially, the lack of control by a collateral taker means that he does not have priority over, for instance, a fixed charge or other acquirers of the charged collateral.

[905] i.e. practical, legal, negative or positive.
[906] Anderson (n 904) 597.
[907] The two English cases discussed in this chapter both dealt with the issue of floating/fixed charge control test. In respect of other fixed securities in English law, such as a legal or equitable mortgage, the problem of control or possession seem not to be an issue. This broadly supports the contention here that the debate about negative, positive, practical, administrative is premised on the fixed/floating charge question.
[908] Beale and others (n 279) para 9.22.
[909] Gullifer, *Goode and Gullifer* (n 275) para 5.40.
[910] ibid 5.41.

It is important to note that there is some relationship between perfection and priority. As Beale *et al* notes, it is quite common to speak about perfecting a security right so that it can become effective against the debtor's administrator, trustee in bankruptcy or other subsequent creditors. This may suggest that perfection is synonymous with priority and, if this is the case, then it can as well be said that the control requirement above, being a priority requirement, is also a perfection requirement. However, Beale *et al* also points out that perfection does not mean priority and vice versa, and this can be seen, for instance, in the case of a subsequent fixed charge taking priority over an earlier registered floating charge. What this therefore suggests is that priority is not synonymous with perfection. In other words, the control requirement above, although a priority requirement, is not a perfection requirement.

More importantly, the control requirement has another function which closely aligns with the earlier discussion. Although not very explicit from the text, this function can be seen from the historical genesis of the floating charge. McKendrick [911] and Gullifer [912] note that the floating charge arose as a need to grant debtors the freedom to deal with their stock in trade and the proceeds arising therefrom in the ordinary course of business. It is noted that it would have been 'impracticable'[913] and created 'intolerable administrative burden'[914] for the debtor to seek the permission of the creditor every time it wanted to dispose of its stock in trade and then segregate the proceeds into the creditor's account. The debtor would have wanted to deal with the stock-in-trade as it deemed fit and then pay the proceeds into its own account, primarily for the continued running of its business. On the contrary, the common law did not allow this type of arrangement because of its strict rules on after-acquired assets.[915] However, equity permitted the arrangement through the floating charge — the effect of which was not to invalidate the security interest, but to postpone its 'attachment' provided the debtor's power to manage the property continued.[916]

The second function of the control requirement can be distilled from this historical development. The above discussion suggests that the floating charge was basically a response to the restrictions placed on the collateral provider not to deal with the assets or rather to yield up control to the collateral taker. It was therefore an exception to the general rule that a collateral taker

[911] McKendrick (n 305) 752.
[912] Gullifer, *Goode and Gullifer* (n 275) para 4.02.
[913] McKendrick (n 305) 752.
[914] Gullifer, *Goode and Gullifer* (n 275) para 4.02.
[915] The common law had strict rules for after-acquired assets which not in existence as at the time of the arrangement. This effectively meant it also frowned at any attempt to grant security over circulating (future) assets, which are often the objects of a floating charge. Robert Pennington, 'The Genesis of the Floating Charge' (1960) 23 MLR 630, 632.
[916] Gullifer, *Goode and Gullifer* (n 275) para 4.02.

ought to have control of the secured assets. This requirement aligns with the discussion seen earlier in this section on the purpose of the control or possession requirement in the Directive. As earlier noted, the control requirement, in the Directive, will seem to be premised on the idea that a collateral provider, who creates a security right, is under a duty to yield up control of the asset. In this regard, a collateral provider cannot have, at the same time, both the benefits of creating a security right in respect of the relevant outstanding obligation and having control of the assets which it can freely deal with, especially considering the third-party effect.

This supports the conclusion that the possession and control requirement is not a perfection requirement. Rather, it is a requirement which imposes a duty on the collateral provider to yield up control of the assets. This purpose closely aligns with the control requirements for the fixed/floating charge distinction, which Ho further confirms, is not a perfection requirement. [917]

10.4.1 Right of substitution: Control requirement as a condition of applicability?

A contrary argument may be made against the analysis above. For instance, Ho argues that the possession/control requirements in English law 'has little relevance' to the interpretation of the possession and control requirement in the Directive.[918] In his view ,this is confirmed by Article 2(2) of the Directive which provides that any right of substitution or right to withdraw excess collateral in favour of the collateral taker, shall not prejudice the financial collateral from been in the possession or under control of the collateral taker.[919] Thus a right of substitution and withdrawal is contrary to the normal position in English law where the right will normally be a badge of a floating charge, since it implies that the collateral provider has control of the collateral.[920] By implication, it means that not even a limited right of substitution will normally be enough to make a charge a fixed charge, since generally under English law, there is a complete prohibition on a collateral provider in a fixed charge from dealing with the assets.[921] It is therefore argued that the level of control in the Directive is different from that under English law, since the Directive presupposes that a fixed charge holder can have control even where the collateral provider has a right to substitute or withdraw collateral.[922]

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[917] Ho (n 301) 163.
[918] ibid 162; Gullifer, 'Financial Collateral' (n 11) 407, footnote 105.
[919] A right to substitute means that, 'in relation to any specific part of the existing collateral, the provider has a complete right to withdraw it, as long as he provides something of equivalent value in return. Similarly, a right to withdraw excess collateral gives the provider the ability to reduce the collateral as a whole, by the withdrawal of any items which he chooses, to whatever low (or sometimes non-existent) level as may be required from time to time by the state of the account between him and the collateral taker'. *Lehman* (n 517) para 133.
[920] *Re Spectrum Plus Ltd* (n 872).
[921] Zaccaria (n 863) 234.
[922] ibid 235.

The above argument misses some key points. However, before considering its pitfalls, it is important to provide some context for the contrary position below. Generally, it is very controversial whether a floating charge comes within the scope of the Directive.[923] This issue is controversial because, as discussed above, what defines a floating charge is the collateral provider's ability to control and manage the assets and withdraw them from the security.[924] However, the possession and control requirement in the Directive defeats this, as it means that it will normally be only charges which give the collateral taker control that comes within the scope of the Directive and Regulations. This type of charges can only be fixed charges. Indeed, as seen in *Gray v GTP*, the court was sceptical regarding whether a floating charge can come within the scope of the Directive on this ground.

However, it has been argued that although many floating charges will not come within the Directive and Regulations, few may come. These charges, as Beale *et al* argue, are floating charges which would be categorised as such only because the chargor has the right to substitute collateral or withdraw excess collateral. This will come within the scope of the Directive because the right to substitute or withdraw excess, as stated, implies the collateral provider has control. The second is where the charge has crystallised (which ends the chargor's authority to deal with the collateral), provided that the collateral taker has taken steps to acquire possession and control, by preventing the collateral provider from dealing with the asset. The implication of the second, as Beale suggests, means that while a floating charge at the point of its creation will not receive protection under the Directive, it will be protected when the charge has crystallised if the collateral taker obtains possession or control before the chargor's insolvency. [925]

Certain related points can be made regarding the views above. First, it may be said that the right of substitution or withdrawal in the Directive is based on the presupposition that a collateral provider does not have control, or rather on the idea that the collateral taker has control. Put differently, the right of substitution or withdrawal will not be important, as suggested by the courts in *Gray v GTP* and *Re Lehmann*, if the collateral provider will normally have the right to deal with the assets as it likes. Thus, it is because it is presupposed that the collateral provider does not have the right to deal with the assets, that it becomes necessary to provide for the right of substitution or withdrawal. If indeed he has the right to deal with the assets, the right will not be needed.

[923] The UK Regulations suggests that it does. See FCAR, reg.3.
[924] *Re Spectrum Plus Ltd* (n 872).
[925] Beale and others (n 279) para 3.89.

On a different note, if indeed the right of substitution or withdrawal gives the collateral provider control over the assets and is thus a badge of a floating charge, as it is generally understood in English law, the implication is that contrary to Beale's argument above, a floating charge ,as it is generally understood in English law, ought indeed to fall within the scope of the Directive and Regulations, since it will then mean that the collateral provider has control. It is either a collateral provider has control, or it does not have control. Thus, it cannot be argued , on the one hand, that a floating charge generally does not fall within the scope of the Directive and Regulations because it gives the collateral provider control and possession, while on the other hand similarly arguing that although a collateral provider has control (because it has a right to substitute or withdraw collateral), that the arrangement is a floating charge and yet falls within the scope of the Directive.

The implication of the point above is seen when we try to reconcile the views of Ho and Beale. As noted above, Ho suggests that a fixed charge will come within the scope of the Directive notwithstanding that there is a right of substitution which is a badge of a floating charge: the charge remain a fixed charges. On the other hand, Beale *et al* argue that one of the few situations where a floating charge will come within the Directive is where there is a right of substitution. Thus, the presence of a right of substitution makes it a floating charge. Comparing these views, it implies that Ho's fixed charge will in fact not be a fixed charge because of the presence of the right of substitution, as suggested by Beale *et al*. It will instead be a floating charge because of the right of substitution. The implication of this is that only floating charges will fall within the Directive once there is a right of substitution, although as noted above the presupposition behind the right of substitution is that the collateral provider does not have control. So obviously the right of substitution presupposes that the collateral taker has possession and control.

A better way of interpreting the provision of the Directive is to differentiate, as seen in earlier chapters, between the condition of applicability and consequences of applicability. The key condition of applicability in the Directive and Regulation is that the collateral taker needs to have possession and control. As noted above, it is only when it has possession and control that the right of substitution arises as a consequence of applicability. Thus, to determine collateral arrangement which fall within the Directive, the first consideration is whether the collateral taker has possession and control. At that stage, the right of substitution is not important. This is the reason why a floating charge will not generally fall within the Directive and Regulations, and why a fixed charge will, in the contrary, fall within the scope of the Directive and Regulations. This is also the reason why, as argued by Beale, a floating charge will not come within the scope of Directive at the point of its creation, but at the point of crystallisation. Thus, there needs to be possession and control before the right of substitution arises as a consequence of applicability.

However, that right of substitution rather than been a badge of floating charge, is merely an exception. It does not convert a fixed charge into a floating charge, or make a charge floating. The charge remains fixed since there is a presupposition, which is behind the right of substitution, that the collateral taker already has possession or control (i.e. condition of applicability). The presence of that right of substitution does not change the fact that there is possession or control.

What this suggests is that it is only Beale *et al*'s second exception above that may qualify as a correct situation/exception where a floating charge falls within the scope of the Directive. A charge does not become floating because of a right of substitution. If it were, all collateral arrangements with a right of substitution will be floating, rather than fixed, charges. The view here suggests that regardless of such right of substitution, the charges remains fixed.

Importantly, another implication of the above analysis is that contrary to Ho's argument that the possession/control requirement in the Directive is different from that in English law, it may be said that they are the same if, as argued, it is accepted that the possession and control requirement in the Directive is a condition of applicability which applies to identify which charges/collateral arrangements fall within the Directive. The right of substitution is not useful for this purpose. It arises after such an arrangement has been identified.

10.5 CONCLUSION

The question in this section has been whether based on the assumption of the functional method, the possession or control requirement in the Directive can have a system-neutral meaning devoid of doctrinal commitments. As demonstrated, the interpretations given by the courts tilt towards a meaning which aligns strongly with English law and the control requirements for distinguishing between fixed and floating charges. This is confirmed by the fact that: first, in the two English cases, the court had consistently referred to the control requirements for fixed/floating charge to hold that the charges are floating and thus falls outwith the Directive. Secondly the purport of those decisions aligns strongly with the CJEU's decision which, as seen above, is said to have followed the two English cases. Thirdly , the courts were concerned with whether the collateral provider was prevented from dealing with the asset. This is despite the fact that in the three cases, the collateral taker had some form of administrative/practical control of the collateral which should have been enough publicity to comply with the perfection requirement in the Directive.[926] Thus, the meaning given to the control requirement aligns with the justification for the fixed/floating charge control

[926] Gullifer, *Goode and Gullifer* (n 275) para 6.43.

requirement, which is not a perfection or publicity measure, but a requirement to ensure the collateral provider does not deal with the collateral.

PART C

11 CHAPTER ELEVEN: CONCLUSION

This chapter brings together the discussions in the previous chapters, and provides a conclusion to the question which has been considered in the thesis, that is: whether as presupposed by the functional method, a system neutral meaning of legal concepts and institutions can be identified in the Directive on financial collateral.

In line with the analysis in the previous chapters, there are two conclusions made below which re-echoes the criticisms against the functional method in chapter two. The first is that contrary to the presuppositions in the Directive regarding a TTFCA and SFCA, it is not possible to define legal institutions in a functional way, in terms of particular effects as presupposed by the Directive. The implication of this is to falsely represent such institutions as existing without any underlying doctrinal principles. Particular effects can only be situated in a network of legal rules and principles forming a doctrinal system.

The second conclusion which is related to the above is that a functionalist cannot define, arrange or group institutions in terms of particular functions, as he likes, as if there is nothing intrinsic in such institutions. Reconstructing an institution in terms of particular consequences necessarily raises a methodological question of how we can identify which particular consequences or effects are important. Because institutions may have different effects, identifying a relevant function implies that a subjective criterion is used.

The two conclusions above re-echo the criticisms highlighted in chapter two against the functional method. The first conclusion affirms the criticism in section 2.3.3 that the functional method is legocentric,[927] is strictly focused on concrete ends and sees nothing outside legal texts; obscures the larger picture;[928] and is inadequate as it cannot tell much about the internal structures of a legal system. [929] These criticisms are another way of expressing the issues demonstrated in the thesis: that effects alone cannot be seen in isolation of the broader doctrinal context. Similarly, the second conclusion endorses the criticism in section 2.3.1. against the methodological adequacy of the functional method, that it does not provide an objective criterion for defining legal institutions: any criteria used is based on a subjective preference.

[927] Frankenberg (n 23) 435.
[928] Graziadei (n 1) 118.
[929] Siems (n 110) 46.

This chapter is divided into two parts. The first part summaries the arguments in the previous chapters. The second part draws the link between the arguments in the previous chapters and the functional method.

11.1 THE CHAPTERS AND ARGUMENTS SUMMARISED

The argument was made that EU directives are functional instruments. This implies that they adopt the functional method. On this note, chapter two considered the origin and assumptions of the functional method. As discussed in the chapter, the functional method arose as a reaction to the contextual study of legal institutions. This approach was considered to be restrictive because it examined legal institutions from a doctrinal or historical perspective. Therefore, the method arose with the aim of providing a system-neutral methodology which transcends national peculiarities. In this light, the method, as discussed in chapter two, makes certain analytical presumptions, amongst which are a) that the function of legal institution is the *tertium comparationis* of comparative law; b) that problems and solutions in legal systems are similar, c) that institutions can be seen outside their doctrinal context exclusively in terms of their effect. It was argued that most of the criticisms against these assumptions are not necessary if, as acknowledged by the proponents of the method, the method is seen as pragmatic and focused on the achievement of results. However, this does not imply that the method does not leave many questions unanswered.

Chapter three considered the manner in which the above presuppositions operate within the context of EU directives. It was argued that implementing laws are deemed to be functionally equivalent and give rise to the same effect. Thus, because they are equivalent, it is possible to identify system-neutral ideas based on their effects. It is presumed that these ideas or concepts cut across national doctrinal peculiarities. In terms of the legislative process of the directive, this implies that the drafting (and concepts) contained in them are presumed to represent transsystemic concepts.

Chapters five to ten test the presupposition of system-neutrality within the context of the Collateral Directive using the definitions of a TTFCA and SFCA. However, before those two arrangements were considered, chapter four examined the objective of the Directive in relation to the TTFCA. The chapter noted that the provisions in the TTFCA were intended to mandate Member States to recognise the TTFCA and not to recharacterise the arrangement as a security device. It was argued that recharacterisation may not be a modern issue, but, historically, was prefigured by sham cases under which parties' agreement was requalified into

something they never intended. It was also demonstrated that issues of recharacterisation normally lead to questions whether a TTFCA is a security right (SFCA). This is because both transactions perform a security function. In determining what amounts to a security right, legal systems generally adopt either a formal or functional approach. The latter considers the economic motive behind a transaction, while the former, which is endorsed by the Directive, defines security in terms of its legal consequences

It was demonstrated in chapter five that the phrase 'full ownership' in the Directive presupposes a unitary concept of ownership. It was argued that while this concept can be identified in Civil law systems, the concept does exist in English law in the way presupposed by the Directive. First, the argument was made that the attempts to identify whether English law has a concept of ownership on the basis of positive or negative powers of an owner, or the internal or external side of real right is influenced by Civil law thinking. Although in English law, some of these powers or rights can be identified, they arise a result of separate solutions, rather than been normatively derived from any concept. Moreover, an equitable interest holder may not have the positive powers as presupposed by those criteria. It was further argued that English law defines property rights in terms of priority of entitlement. This is underlined by the relative nature of property interests. At an institutional level, this division is seen along the lines of common law and equity. However, within these individual institutions, there is also a relative approach to property. In the common law, title is normally defined in terms of the party who has the best right to possess, although the common law recognises that the title holder can exercise all the rights of an owner which leads to the achievement of an equivalent result as that seen in Civil law. In relation to beneficial ownership, it was demonstrated that property is fragmented between the trustee and the beneficiary. Since title is fragmented, this suggests that no party has full ownership. In specific relation to the nature of the beneficial right, it was argued that there may be reasons to hold that it is not an ownership right: first, the right is defined as a negative right of non-interference without the positive side of ownership which contrasts with the view that the right of ownership confers both positive and negative powers. Secondly, the nature of the right changes depending on who has custody, lawfully or unlawfully, of the asset. Thirdly, the debates on its nature suggest that it is merely a right *in rem*, rather than an ownership right. If this is the case, it is likely that it is to be characterised as a limited right (SFCA), rather than a right of ownership (TTFCA). It was also argued that the insolvency protection conferred on the beneficial right arises from the general concept of

relativity in English law: while the trustee is owner outwith insolvency, the beneficiary is deemed to have a better title within insolvency.

Chapter six demonstrates that the idea of ownership of financial collateral is system-dependent. In providing an answer to this question, the chapter examines the two contrasting approaches to this question. The first approach, influenced by the Pandectists, argues that it is only corporeal objects which can be the objects of ownership, although a person can be 'entitled' to a claim. The second approach, which finds support among doctrinal writers such as Benjamin, Rahmatian and, Reid holds that both corporeal and incorporeal objects, including claims, can be the object of ownership. Drawing from these two approaches, several arguments were made: first, it was argued that the two approaches define real rights differently depending on their commitment to protect the property/obligation boundary. While the first approach protects this boundary, the second does not. It was demonstrated that one of the effects of the second approach is that it defines real rights as particular manifestations of personal right. Regardless of their different consequences, some functional similarity was identified in the two approaches: they both agree that collateral can be transferred; can be used as the object of security right, and vindicated against third parties. This similarity is also seen in the way the Directive casts the TTFCA in the presupposition that both the concepts of full ownership and full entitlement perform equivalent functions, as seen from the fact that a person 'entitled' to a right can create an SFCA. However, it was argued that although some of these contents are functionally equivalent, there are others which are not. For example, in relation to the right of disposal (*abusus)*, a person entitled to a claim does not have the power to extinguish the right to receive payment of a debt. Primarily, the debtor can oblige a creditor to accept payment that he no longer wants. The underlying basis for this, it was argued, is because the internal structure of the primary right is personal; the right follows a person.

Chapter seven identifies two functional criteria (i.e. conditions of applicability) provided in the Directive, which can be used to identify a TTFCA. The criteria are that: a) ownership is transferred b) for the purpose of securing a transaction. It was argued that while the Directive adopts a functional approach to identify those two criteria, it applies a formal approach to treat a TTFCA as actually creating the rights which they purport to create. Having identified those conditions, the chapter applied them to identify the equivalent transactions in Dutch and Scots law : *fiducia cum creditore*. The argument was made that regardless of the restrictions (i.e. consequences of applicability) placed on these institutions by some legal systems, such as the publicity rules or restrictions on the collateral taker not to deal with the

assets, the arrangements in these systems fulfilled the two conditions of applicability above and therefore were TTFCAs. This is because, as argued, the Directive does not identify these institutions based on the publicity rule or the other restriction placed on them by the legal system, which are merely consequences. Rather it identifies the institutions based on whether they fulfil the conditions of applicability above.

Chapter eight applies the conditions of applicability above to the English legal mortgage. It was argued that the legal mortgage satisfies the two conditions of applicability from the 'external' perspective of the Directive and thus qualifies as a TTFCA. However, it was argued that this cannot be the consequences desired by the Directive and English law. This is because from the 'internal' perspective of English law, a legal mortgage, though a transfer, is a security device. Using the UK implementing Regulations, the chapter demonstrated how English law goes around this potential risk of characterising a legal mortgage as a TTFCA: this depends on the relationship between legal ownership and equitable ownership. Although legal ownership is normally conceptualised as the primary right, it was seen that in a legal mortgage, the 'equity of redemption', which is a beneficial interest, trumps legal ownership. Within this context, the equity of redemption is treated as a residual right, suggesting it is an ownership interest. This analysis means the equity of redemption, within this context of the Regulations and Directive, cannot be treated as a personal right or merely as a limited right: treating it as such implies that the definition in the Regulations will be conceptually unworkable. However, it was argued that this does not mean that beneficial interest in all cases is a primary right: the interpretation given to it within this context reflects the relative nature of English law, since generally legal ownership is treated as the primary right. On the whole, the analysis in the chapter demonstrates that a TTFCA in the Directive can only be seen within the doctrinal context of English law, not in terms of the particular functional criteria stipulated in the Directive.

Chapter nine identified the two conditions for a transaction to be an SFCA: first, the collateral must be provided by way of security , and secondly the collateral provider must retain ownership of the asset. It was argued that the term 'by way of security', based on the German translation of the Directive, denotes a concept of security which the Directive presupposes can be found in the legal systems of all Member States. However, it was argued that it may not be possible to identify such a concept in some systems, because the Directive, influenced by the Civil law approach, presupposes that there is a clear conceptual distinction between an SFCA and TTFCA. This thinking takes an *a priori* approach in demarcating, conceptually, the boundaries between a

transfer and a security right. The effect of this was that institutions such as a legal mortgage, which are essentially transfers may fall outside what may constitute 'by way of security'. Essentially, this suggests that the meaning of the term is system-dependent. It was further demonstrated that although there are functional similarities among systems regarding how they define security rights (i.e. for example the no-tradability function), it is not fruitful to identify a concept based on such effects because a) first, those effects are simply consequences of broader doctrinal principles and thus the effects cannot be seen in isolation of those principles and b) secondly, since the institutions are different in other respects, there may be some subjective preference for using particular similarities to identify any meaning to be ascribed to such institution, giving rise to a bias for similarity.

Chapter ten considered whether we can identify a system-neutral meaning of the concept of possession and control in relation to an SFCA. it was argued: first, the interpretation given to the possession and control requirement by the courts, endorses the English law idea of control which is based on the fixed/floating charge distinction. This is confirmed by the fact that: a) first, there is a clear alignment of the decisions of the courts examined in the chapter and b) secondly, that the interpretation by the courts of the possession and control requirements in the Directive supposes that it performs the same function as the control requirement under English law. It was argued that although there are situations where the control requirements in English law is different from the control requirement in the Directive, those particular situations are only carve-outs or exceptions under the Directive. The general rule which applies is that the collateral taker must have possession or control. This requirement is used to identify which arrangements fall within the Directive. It is only when such an arrangement is identified that the exceptions arise.

11.2 FUNCTIONAL METHOD AND THE COLLATERAL DIRECTIVE

The question is: what are the implications of the above findings for the purpose of the functional method? In summary, two conclusions can be made which re-echoes the criticisms in chapter two against the functional method. First, institutions cannot be defined by particular consequences or effects. They can only be defined within a doctrinal context. Secondly, because institutions can only be seen within a doctrinal context, it becomes problematic to identify the particular effect or function to be used to describe such an institution normatively.

11.2.1 Legal institutions as doctrinal institutions

As discussed in chapter two, the functional method reconstructs doctrinal context into functional relations or in terms of their consequences.[930] In achieving this effect, the functionalists emphasise the view of law in terms of a specific function, while ignoring its context. Michaels suggests that the reconstructive move by the functionalist presupposes that the functional method does not seek to capture some 'essence' of legal institutions as that will run counter to its own programme.[931]

However, chapters five to ten demonstrate why such a constructivist move is not possible. First, chapter five demonstrates *inter alia* that we cannot conclude that beneficial interest is full ownership because the beneficiary has the powers normally ascribed to an owner. As argued, even if it is accepted that beneficial interest is a property right, there seems to be an agreement that it is not an ownership right in the sense of a right which confers the full panoply of positive and negative rights in an asset in the Civilian sense. This is because, as argued, the positive rights vested in a beneficiary are not consistent to base a principle upon, and the beneficiary's right is described as a negative right of non-interference. Chapter six similarly demonstrates that what qualifies as objects of ownership can only be seen within specific doctrinal contexts. This is reflected in the two contrasting approaches discussed in the chapter. In chapters seven and eight, it was demonstrated that what amounts to a TTFCA is system-dependent, since based on the drafting of the Directive a legal mortgage convincingly satisfies the two functional criteria or conditions of applicability in the Directive and therefore falls within the definition of a TTFCA. However, it was argued that the only reason why a legal mortgage will not fall within the Directive is if English law doctrinal principles are applied: that is, if the equity of redemption is considered to be a residual right for the purpose of a legal mortgage, although there are alternative interpretations in English law in relation to the nature of an equitable right. In chapter nine, it was demonstrated that the two requirements for the identification of an SFCA (i.e. by way of security and ownership retention) can only be seen within the doctrinal context. This was buttressed by the fact that while the Directive presumes that there is a conceptual distinction between a transfer and a security, this may not always be the case for some systems. Therefore, it is not fruitful to define a security right using that demarcation. Furthermore, chapter ten also demonstrates that contrary to the provision of the Directive, the possession and control requirement is heavily influenced by the doctrinal

[930] Michaels (n 1) 365.
[931] ibid.

principles of English law. This was demonstrated by the fact that the interpretation given by the courts closely aligns with the fixed/floating charge control requirement in English law. This is further confirmed by the fact that the function of the possession/control requirement in the Directive is the same as that for the control requirement in fixed /charge control requirement.

The discussion in the thesis suggest that institutions do not exist in terms of particular functions, as presupposed by the functional method. They can only be situated within a doctrinal context. The analysis provided in the thesis re-echoes the criticism highlighted in chapter two against the functional method, that the method is inadequate as it cannot tell much about the internal structures of a legal system,[932] or that the approach is legocentric [933] and strictly focused on concrete ends, seeing nothing outside legal texts. Graziadei similarly notes that the method obscures the larger picture which should always matter. [934] This is likewise not different from Frankenberg's criticism against the method that 'multiple and cross-cutting processes contributing to the change of legal norms, doctrines and institutions' are dissected only to be translated into one master process without consideration of the larger picture. [935]

These authors highlight the importance of doctrinal context to the way an institution is understood. As the thesis has demonstrated, this is right, although the position here is that context matters not just from the negative angle (i.e. that it simply ought to be considered) but from a positive angle (i.e. it is intrinsic to how institutions are defined).

11.2.2 Function as subjective

Related to the foregoing, it may be said that because the functional method is constructivist and rejects that institutions have an inherent purpose, any constructivist move can only be premised on a subjective reality dependent on the functionalist, rather than on the inherent purpose or doctrinal context of such an institution. Thus, this gives rise to the problem, discussed in chapter two, and demonstrated in the thesis, of identifying the criteria for determining particular functions or effects. For example, as demonstrated in chapter five, the idea of 'full ownership' in the Directive obviously shows some subjective preference for the Civil law ownership concept. This preference is also seen in the presuppositions to define full ownership in terms of the positive and negative contents of an owner. As demonstrated, these

[932] Siems (n 110) 46.
[933] Frankenberg (n 23) 435.
[934] Graziadei (n 1) 118.
[935] Frankenberg (n 23) 438.

are criteria which may not fit well into the doctrinal understanding of property rights in English law, especially as it is understood in equity where the beneficiary's right is conceptualised as a negative right of non-interference without the positive powers. The same view can also be expressed in relation to other issues discussed in the thesis. For example, it was discussed that the Directive structures a TTFCA and an SFCA in a way which suggests that a transfer (TTFCA) performs a different function from a security right (SFCA). It was argued that while this view may find strong support in Civil law systems which may have a fairly clear concept of security, the same cannot be said about English law, which as noted, defines security devices based on particular effects. Thus, regarding English law, it is easy to conflate the idea of transfer (i.e. legal mortgage) and a security since the relevant focus is on the effects of these transactions, rather than on any *a priori* categories which demarcates them. In relation to the control and possession requirements, it was similarly demonstrated that the meaning given to those ideas strongly aligns with the English law idea of control in particular reference to fixed/floating charge distinction, unlike in Civil law where it is in the nature of a security right that they are binding on successors and cannot be freely disposed and thus questions about the nature of control is less important.

The above examples relate to issues already discussed in section 2.3.1 regarding the criteria used in identifying function or particular effects. As discussed in chapter two, in reconstructing context into specific effects or function, there may be a question as to which function or effect to use, since an institution may have different effects. For example, in the discussion on beneficial interest, there is a question whether to define it as an ownership right in terms of its insolvency effect or based on the rights and powers normally vested in an owner, or on its third-party effects. However, there is another question whether these criteria are objective criteria in defining what amounts to ownership across systems, since for example, the third-party effects may be explained in an alternative way as arising in the protection of personal rights. Thus, it may not even be a criterion for identifying a property institution and ownership. Even where it refers to a real right, it could be that it is a limited real right rather than ownership as demonstrated in section 5.4.5.1. Regarding insolvency protection, there are also questions regarding whether it is a self-evident criterion of ownership, and whether the rationale for the protection is not based simply on a legislative decision, rather than the fact that it is an ownership interest. Thus, any of these criteria chosen may have some subjective basis.

The discussion above indicates that once institutions are seen outside their context to be defined in terms of criteria, some elements of subjectivity sneak in. Hill, as highlighted in chapter two, makes a similar point that: 'any attempts to identify the function of legal institutions depend on subjective interpretations, which cannot be divorced from value-judgments'.[936] Thus, because the functional method is constructivist and rejects that institutions have an inherent purpose, any constructivist move can only be premised on a subjective criteria, rather than on the inherent purpose or doctrinal context.

11.3 FUNCTIONAL METHOD AND PRAGMATIC RESULTS

The conclusions above should not be misinterpreted to mean that prominence is given to the internal structure of a national system, and this, by implication, negates the harmonisation objectives of the EU which seeks to bring together national systems. However, the issue is not about the prominence of national doctrinal principles vis-à-vis EU norms, but rather about the robustness of the methodological tool which is used to achieve the aims of such harmonisation. From a practical angle, it is obvious that the Collateral Directive has been implemented in an effective way, regardless of the theoretical problems highlighted in the thesis. This, in some ways, confirms Gordley's statement that the functional method helps lawyers achieve results which are respected.[937]

However, the analysis and conclusion in the thesis seeks to consider the robustness of the functional method as a tool to identify a system-neutral meaning based on functional similarities in legal systems. Conceptually, it will seem that while on the one hand the functional method endorses the idea of universalization, on the other hand, it overlooks differences, especially doctrinal differences — showing some bias towards similarity. Importantly, this bias, within the context of the Collateral Directive, is based on the presumption that it easier to harmonise legal concepts when the focus is on what is similar among those concepts. But the point is that in identifying similarities and doing away with differences, there is the risk of prejudicially imposing one idea at the expense of other equally valid ideas, as seen most especially in the case of full ownership in the Directive (chapter five), the meaning of an SFCA (chapter 9) and the possession and control requirement (chapter 10). There is also the risk of concluding that institutions are similar when in fact they are not, as

[936] Hill (n 105) 101.
[937] Gordley (n 28) 107.

seen in the case of an SFCA and a legal mortgage. Importantly, the first point above raises an issue: that is, whether, as noted by Michaels,[938] the functional method is not itself dogmatic, and formalistic, endorsing one value as opposed to others, therefore contradicting its own tenets on objectivity and universalization. It could be that the idea of universalization is much more suited for a method which considers not just similarities but differences. Such a method is worth exploring for property law.[939]

11.3.1 Limitations and Future Impact: Functional method, EU law and harmonisation

The thesis has used the Financial Collateral Directive as a crucible within which the functional method of comparative law and its alleged presumption of system-neutrality of concepts can be tested. As such, the findings in the thesis provide only a limited sample of the inadequacy of this presumption within the specific context of the Collateral Directive. Notwithstanding this limited scope of focus and impact, the thesis provides a foundation to access other EU directives in the same way as carried out in the thesis. On this note, chapter three provides some useful background: it sets out a theoretical framework of how EU directives adopt a functional methodology and, more particularly, how the concepts they contain are alleged to be system neutral. This provides a starting point to apply the functional method to other EU directives and then further test the weakness of the functional method and the presumption of system-neutrality of EU directives in the wider context of EU harmonisation agenda.

Although the focus of this thesis has been EU directives, it may be said that the arguments in the thesis on the functional method and the alleged system-neutrality of concepts may equally broadly apply to EU regulations which normally may set out definitions in the presumption that Member States ought to have equivalent institutions. For example, the Insolvency Proceedings Regulations defines a right *in rem* as a right which is 'recorded in a pubic register and enforceable against third parties'.[940] Without considering the substance of this definition, which may be faulted

[938] Michaels (n 1) 372.

[939] A better methodology may be one which, as Michaels suggests, does not over-exaggerate the 'Other' (differences), but treats them both alike. See Michaels article which explores such a method from the conflict of law angle: Ralf Michaels, 'Private International Law as an Ethic of Responsivity' in Veronica Abou-Nigm and Maria Taquela (eds), *Diversity and Integration in Private International Law* (Edinburgh University Press 2019) An online copy of Michaels article may be found here: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3251422> accessed 3 February 2019.

[940] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on Insolvency Proceedings (2015) OJ L141/19, art 8 (3)

on grounds already suggested in sections 5.4.1.1 and 6.5.1,941 it may be argued that the definition provides a good example of where an EU regulation similarly adopts specific functional criteria (i.e. a right registered in a public register and enforceable against third parties) in the alleged presumption that those specific criteria are present in every Member State. Essentially, the approach used in that definition under the Regulation is not different from the approach used in the definition of a TTFCA and an SFCA in the Collateral Directive: the two legislations define concepts in terms of specific criteria and effects. This therefore hints, though on a limited scale, that some EU regulations may indeed adopt the functional approach. Perhaps, it may not be surprising to say that EU laws broadly adopt a functional approach, since, as noted in section 3.4, there is an implicit assumption in EU harmonisation agenda that the legal systems of the Member States are indeed different. However, to bring the systems together – not doctrinally but functionally— it becomes necessary to assume that the systems are similar in terms of the legal effects which their various institutions give rise to. This necessarily implies similarity in terms of the functions of the respective legal institutions in Member States, which feeds into the respective legislations, be it a Directive or a Regulation In this regard, the thesis therefore provides a good foundation and theoretical framework to access the functional method and the alleged system-neutrality of concepts within the wider context of EU harmonisation agenda.

[941] I.e. that third party effects are not good criteria for identifying a real right. On the public register requirement, see also section 10.2 where it was noted that ownership (a real right) may pass under the Sale of Goods Act by a mere agreement without an external act or registration.

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