THE NATURE OF MOVABLE AND IMMOVABLE COLLATERAL AND THE CONSEQUENCES FOR REGISTRIES

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BACKGROUND

Access to credit is an important driving force in economic growth. It ranks high on the list of factors emphasized by individual entrepreneurs, and small and medium sized enterprises as critical to the survival and growth of their businesses with the concomitant job retention and creation and other benefits to the general welfare of society as a whole. Movable and immovable property offered as collateral make the extension of credit attractive to lenders and readily available to businesses on favorable terms. The legal and infrastructural framework, however, must be in place for collateralized lending to function in the credit market. Movable and immovable property registries are an essential component of the necessary infrastructure.

Due in large part to the nature of collateral in general the suggestion is occasionally made to combine movable and immovable property registries. To be sure, there are similarities between mortgages in real estate and security interests in movable property. Both mortgages and security interests serve as collateral for a debt. Both provide that if the debt is in default the secured party can look to the collateral to satisfy the debt. Lenders in assessing the risk of making a loan refer to the registries to determine whether or not a prospective borrower has an interest in the property intended as collateral and whether or not that intended collateral is subject to prior encumbrances. An initial impression is thus that mortgages and security interests should be treated alike and registered in the same registry.

However, the similarities mislead, since they don't take into account the fundamental differences between movable and immovable property and the consequences of these differences in the establishment of registries. Combining movable and immovable property registries actually increases the complexity that lenders must deal with, because the nature of the property demands that a search for encumbrances against movable property be conducted differently than a search for encumbrances in immovable property. As a consequence, international practice is to keep the registries separately.

THE NATURE OF MOVABLE AND IMMOVABLE PROPERTY

The essential distinctiveness of various types of property customarily used as collateral are reflected in the very terms “movable” and “immovable”. Immovable property has a specific geographic location that can be uniquely defined and described and has a physical manifestation in land or the buildings and other objects attached to the land. For land and other real estate the object of property does not exist unless it is uniquely defined and located spatially by what is commonly referred to as its legal description or parcel identifier. Establishing this geographical location and linking it to a cartographic representation is called property formation and this formation itself must be registered in order for the property to exist as a legal object. Once the immovable object has been established rights in the object can also be created. The attributes of movable property, on the other hand, whether physical objects, such as goods, or property with an abstract character by its nature or by operation of law, diverge from the attributes of immovable property. Movable property might be fungible such as grain or cash or transient and substitutable (inventory, accounts, proceeds) or intangible such as electricity, intellectual property, and accounts. The salient feature of movable property is that it cannot be described uniquely with regard to its physical location. Movable property is ephemeral and changing and moves from location to location or is impossible to locate physically (intellectual property rights) or for practical reasons cannot be located with certainty (electricity). Except for certain clearly defined types of movable property such as aircraft and vehicles, movable property can only be generally described. The prominent difference between immovable property and movable property is that the former is uniquely defined with respect to its location, the latter is not.

RIGHTS IN IMMOVABLE AND MOVABLE PROPERTY

Because of the unsettled location of movable property, rights in this property are registered and indexed according to the name of the person (juridical or physical) that granted the rights. The property itself is not registered, nor is the name of the owner. In fact the ownership or title to movable property is quite irrelevant and consequently title has been marginalized in

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1 There are jurisdictions that administer the two systems in the same office, but they do not combine the registries and the laws that govern the two are also separate.

2 From jurisdiction to jurisdictions there may be legal distinctions, such as inheritability, which do reflect the distinction of mobility, but these are not relevant to this discussion.
some jurisdictions. Only security interests in the property are registered. Ownership of movable property is established without reference to the registry. The registry serves not to establish that a prospective borrower is the owner of property to be given as collateral, rather only as a means to discover whether or not the prospective borrower has previously given the property to a lender as collateral. Consequently, searches of the registry are done by looking up the name of the debtor to see whether that person has transferred any rights to property. A search by description of the property, even a general description, reveals nothing interesting for the property itself is not registered.

The case is quite distinguishable for immovable property. Although it is possible to set up real estate registration systems by name of the right holder, experience has shown that such systems are terribly inefficient for searching for rights in real estate. The literature on the subject is replete with discussions of the relative merits of land records set up by parcel as opposed to land records set up by name. In modern, efficient land registries the parcel is registered and all searches are conducted with reference to the parcel identifier and not by a person’s name. In fact, a search of real estate by name of a person will not necessarily show outstanding, valid rights against the property. Rights in real estate may have been established years and years ago and through mesne conveyances the property is owned by a person who had nothing to do with the creation of those rights. To search the present owner’s name will not disclose these significant rights. Consider the following simplest of examples:

In 1990 John Smith is the owner of Blackacre and gives a mortgage to Bank. In 1995 John Smith sells and conveys Blackacre to Bob Jones, who takes the land subject to the mortgage in favor of Bank. In 2000 Bob Jones would like to borrow money and give a mortgage on Blackacre to Lender to secure the loan.

In this example, if Lender wants to determine what rights exist against Blackacre and searches by the owner’s, Bob Jones’, name, no mortgage will be disclosed by the search, because Bob Jones has never given a mortgage against Blackacre before. If, on the other hand, the search is done by parcel, the outstanding mortgage in favor of Bank will readily appear in the search. Lender will know that there is a prior mortgage.

Of course, this is true for all types of real estate rights and encumbrances. To cite just one more example, let’s assume that a restriction that was created on a parcel many years ago has been registered by a former owner stating that no building over a certain height can be constructed, and if violated, the ownership reverts back to said former owner. Let’s further assume that the person that had created that restriction still owns the adjacent land to the north and had created that restriction so that his northerly parcel would always bask in sunlight, which he needs for his solar heating unit on the northern parcel. Even though ownership to the southern parcel has been conveyed several times the parcel is still affected by the restriction. If the present owner of the southern parcel is seeking financing to build high-rise condominium units, a construction lender who will take a mortgage on the southern parcel securing the loan, will need to know about the restriction. A search by name of the present owner to the southern parcel will not disclose the restriction, because the present owner was not a party to the restriction. A search by parcel will easily disclose it.

So, rights that have been granted in movable property are found by searching the name of a prospective debtor, but rights to immovable property need to be searched by parcel. No efficiencies are created by combining the two systems, because the searches with the combined system will still need to be conducted completely differently for movable and immovable property. Indeed, no duplication of effort is avoided. If a lender is interested in land as collateral, it must search by parcel. If a lender is interested in movable property the search must be done by name.

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3 This is the case in the United States under the Uniform Commercial Code. However, there are exceptions for certain types of property such as vehicles. These titles are often registered under a vehicle registration law maintained separately from the registration of security interests in the Secretary of States’ offices.

4 This is actually quite understandable, for it would be a significant burden to require an owner to register all movable property to establish ownership. Once again, major expensive items such as vehicles are exceptions.

5 It is possible to index real property rights by name, as pointed out above, but the only way to find these rights is to chain up the so-called chain of title switching back and forth between grantee and grantor indices, and then look at the grantor index for all those appearing in the chain, for the period that they had rights in the property, to make sure that no rights were granted out. Obviously, this is very tedious work, as anyone who has engaged in this type of title search will avow. This inefficient method for finding the relevant rights and encumbrance for a tract of real estate is avoided by setting up real estate title systems by parcel. This author was Deputy Examiner of Titles for Hennepin County, in Minneapolis, MN, U.S.A. from 1983 until 1994 and has conducted hundreds of title searches using both types. If, indeed, further support is needed, let this experience support my testimonial that real estate registries must be set up by parcel.
THE CONCEPT OF PRIORITY

Priority of rights is often mentioned in the context of secured credit transactions, but it is necessary to closely explore what it means from a legal perspective to have a “prior” right. Generally, when referring to movable property, priority is only relevant to determine what order secured creditors will be paid from the proceeds of a forced sale if the debtor defaults, and is only significant if the value of the collateral is not sufficient to satisfy all the obligations it secures. Although this is true for real estate mortgages, too, priority has a much more significant legal importance with respect to rights in real estate that has nothing to do with payment of credit. The concept of priority for real estate must be defined in terms of the notion of “free and clear” and must subsume all rights in the real estate. A person holding a prior right holds that right free and clear of any and all rights that are junior. Any discussion of the priority of real estate rights must deal with the relative priorities between the whole range of rights in real estate, including priorities between mortgages and leases, mortgages and servitudes, mortgages and restrictions, priorities among leases, servitudes and restrictions, and priority regarding the transfer of ownership.

Priority is simply a legal consequence of two principles that must in some manner be established by law granting protection to those who register their rights and no protection to those who fail to register their rights. These propositions can be stated as:

PROVISION 1
Every right from the time of its registration shall be notice to persons dealing with the property thereafter of the registered right.

PROVISION 2
Every person dealing with a registered parcel of land or other real estate may accept that the rights disclosed by the registry are the only rights affecting the land or other real estate and shall hold his registered right free from all rights, encumbrances, restrictions and adverse claims, except the rights, encumbrances, restrictions and adverse claims registered before he registers his right.

This concept of “Notice”, in Provision 1, is the most basic of all the legal provisions in a registration law. It is the principle that provides the protection for those who have registered their rights. Provision 2 is the principle that limits the extent of the search for rights that a purchaser must make. Provision 2 is linked crucially to the provision of the registration law that defines which rights must be registered. Provision 2 ensures that a person need examine only the records in the registration system to determine the status of the legal rights in a parcel of real estate. It is important when establishing a system for the registration of real estate rights to include a provision that thus limits the search that a person must make. Such a provision not only limits the extent of the search of the purchaser, but also provides a very strong legal incentive for a person who has acquired rights to register these rights. If the rights are not so registered there will be no notice of those rights and persons dealing with the parcel will acquire their rights free of the unregistered rights.

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6 A contention may be set forth that there may be efficiencies in the administration of the two separate systems operated by the same authority. The validity of such a contention really depends upon factors not germane to this paper. What institutions are in charge of mapping? What institutions are in charge of real estate formation and the records? Where do transactions take place? Where are the real estate professionals located? How many parcels exist and how often do transactions take place? How large a geographic area is involved? Where do the courts exist that will adjudicate real estate rights? These and many other questions must be specifically answered before an opinion can be formed as to where the most efficient place is to locate land and real estate registration offices. No assertion that combining real estate registries and movable property registries without a very detailed analysis of these issues and the political implications is sustainable.

7 There is an area that becomes somewhat nebulous in this regard, because some of the laws regarding real property, such as environmental laws, zoning laws and taxation law, for example, may limit the uses to which real property can be put, whether or not a document is registered regarding these limitations or obligations. Generally limitations that cover large areas and affect all the parcels in the area are not subject to the registration laws, whereas limitations that are specific to one or a few individual parcels are subject to registration. Servitudes appear to be exceptions to this general rule inasmuch as a servitude for electrical lines can affect hundreds or thousands of parcels and nevertheless is usually covered by state registration. Servitudes, however, usually encumber just a portion of each parcel and therefore have a different character than limitations used in planning and management of wide geographic areas.

8 If the legal principles are developed in a registration law as set out in this discussion the incentives for use of the system will be present. The registration systems in the United States are optional, but it is the practice to register or record information as soon as possible after transactions are completed, because one’s legal rights can be involuntarily compromised if the rights are not
The issue of “notice” is central to the practice of real estate law. The object of any purchaser, mortgagee, or lessee during the course of a real estate transaction is to identify all the risks that he needs to address to acquire the right he intends to acquire free and clear of those rights which will limit or compromise the intended right. In most real estate transactions the person acquiring a right intends that he acquires it “subject to” certain rights and “free and clear” of others.

Consider an example:

**EXAMPLE 1**

The owner of a parcel of real estate is Party O. Party O grants a servitude for ingress and egress in favor of Party N, the owner of a parcel adjoining the real estate in question. The ownership is registered in O and the servitude is registered by N, so that the title is:

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Encumbrances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Party O</td>
<td>Servitude in favor of Party N</td>
</tr>
</tbody>
</table>

Party O then leases the premises in favor of Party L and the lease agreement is registered. The title is now:

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Encumbrances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Party O</td>
<td>Servitude in favor of Party N</td>
</tr>
<tr>
<td></td>
<td>Lease in favor of Party L</td>
</tr>
</tbody>
</table>

Party L takes possession of the property and starts to use it pursuant to the lease. Party N then begins to use the servitude and Party L objects. Party N can show that he registered his servitude and that Party L had notice of this servitude by operation of the registry law. Furthermore, Party N registered the servitude at a time when there was no lease registered and therefore is not bound by the lease in favor of Party L even if the lease had been granted by Party O to Party L prior to the granting of the servitude.

The servitude is held “free and clear” of the lease. Party L acquired the lease right at a time when the servitude had been registered and thus pursuant to Provision 1 is deemed to have had notice of the servitude, whether or not Party L reviewed the registry when he acquired his lease. He is bound by the servitude in favor of Party N and legally must let Party N use the servitude. The servitude is said to be prior to the lease.

Next consider a more complicated situation involving the mortgage of a parcel. The mortgage is more complicated, since, if the mortgagor defaults in the mortgage, the lender/mortgagee can acquire the rights of the mortgagor in accordance with the law of mortgage enforcement.

**EXAMPLE 2**

registered or recorded.

9 It is customary for a person examining title to diagram the title. Diagrams are a matter of personal taste and experience, but the most common form is one that divides a sheet of paper down the middle, and then follows the chain of ownership down the left side, while noting any leases, mortgages, servitudes, covenants, conditions, restrictions and other encumbrances down the right side. These diagrams often indicate the date, the instrument number or book and page, and often the beneficiary of the interest, both for ownership and for encumbrances. In practice, if the person in an entry conveys the ownership, only the grantee is shown in the next entry. If there are any problems with the conveyance, those are shown as a notation on the encumbrance side of the sheet. The examples that appear below follow this convention i.e. the chain of ownership is followed on the left side of each diagram and encumbrances are noted on the right. The examples, however, as a matter of convenience show only skeletal information for the sake of clarity, and don’t show the extended information that might be represented in a typical diagram.

10 In some jurisdictions, possession of real estate also puts subsequent right holders on notice of the possessor’s rights and the subsequent right holder is obligated to make enquiry as the rights of parties in possession, but for the purpose of this discussion, we can assume that such rules do not apply.

11 Leases and servitudes are generally not inconsistent and can coexist as encumbrances on one parcel of real estate. The lessee and the person entitled to use the servitude can each fully enjoy the rights held.

12 This is usually through forced sale of the premises, but in many countries, if there are not adequate bidders at the sale, the mortgagee can bid in the debt owed on the mortgage and acquire the rights that the debtor had granted in the mortgage.
Assume that Party O is the owner of a parcel of real estate and gives a mortgage to a lender, Bank B, as security for a loan from Bank B. The mortgage is registered so that title is the following:

Ownership | Encumbrances  
---|---
Party O | Mortgage in favor of Bank B

If Party O defaults in the conditions of the loan, then by whatever procedure is defined by law, the mortgagee, Bank B, acquires the rights that Party O had when he gave the mortgage and the mortgage is extinguished. Consequently, the title is:

Ownership | Encumbrances  
---|---
Bank B | 

The important concept here is that when Bank B takes the mortgage in the first place, it acquires the right to obtain, in case of default on the mortgage, exactly all the rights that Party O had granted in the mortgage.

EXAMPLE 3

Assume that title to a parcel is as follows:

Ownership | Encumbrances  
---|---
Party O | Servitude in favor of Party N  
 | Lease in favor of Party L

Party O, the owner, now gives a mortgage to Bank B, which is immediately registered.

Ownership | Encumbrances  
---|---
Party O | Servitude in favor of Party N  
 | Lease in favor of Party L  
 | Mortgage to Bank B

The mortgagee, Bank B, acquires the right, by the mortgage, to get only what Party O had at the time the mortgage was registered, namely ownership, subject to a servitude in favor of Party N and a lease in favor of Party L. If Bank B forecloses its mortgage the title will be as follows\(^\text{13}\):

Ownership | Encumbrances  
---|---
Bank B | Servitude in favor of Party N  
 | Lease in favor of Party L

Bank B is now the owner of the premises subject to the servitude and subject to the lease. The servitude and the lease had been registered prior to the mortgage and so these rights cannot be adversely affected by anything that happens legally with respect to the mortgage. The servitude and the lease have priority over the mortgage.

\(^\text{13}\) This assumes that the mortgage laws require a public auction of the premises to enforce the mortgage upon default and the only bidder is the Bank.
Next consider the following situation:

**EXAMPLE 4**

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Encumbrances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Party O</td>
<td>Servitude in favor of Party N</td>
</tr>
<tr>
<td></td>
<td>Mortgage to Bank B</td>
</tr>
<tr>
<td></td>
<td>Lease in favor Party L</td>
</tr>
</tbody>
</table>

This example differs from Example 3 in that at the time the mortgage was registered there was no registered lease. After the mortgage had been registered Party O had leased the premises to Party L. Assume now that Party O defaults in the mortgage and Bank B forecloses. Bank B had been bound by the servitude in favor of Party N, but was not bound by the lease in favor of Party L. The Bank acquires the ownership free and clear of rights that were registered subsequent to the mortgage. After the foreclosure the lease is gone, but the servitude remains. Title is as follows:

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Encumbrances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank B</td>
<td>Servitude in favor of Party N</td>
</tr>
</tbody>
</table>

**EXAMPLE 5**

At a time when the real estate is subject to a mortgage in favor of Bank B, Party O grants a servitude for ingress and egress to his neighbor, Party N, and Bank B does not join in granting or consenting to the servitude.

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Encumbrances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Party O</td>
<td>Mortgage to Bank B</td>
</tr>
<tr>
<td></td>
<td>Servitude in favor of Party N</td>
</tr>
</tbody>
</table>

Assume that Bank B forecloses its mortgage. Since Bank B had a registered right before the servitude was granted, Bank B’s mortgage was free and clear of the servitude. The title, after foreclosure, is:

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Encumbrances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank B</td>
<td></td>
</tr>
</tbody>
</table>

These examples illustrate that whether or not the rights are “subject to” or “free and clear” of other rights follows directly from the application of Provisions 1 and 2. Essentially, then, these provisions define the legal relationships between all registered rights and establish the relative priorities of the rights.

The examples demonstrate that priority is a broader concept than is established by movable property laws and registries, which focus on relative rights to payment out of the proceeds of forced sales. Priority principles apply to all rights in real estate including ownership, encumbrances, appurtenances and restrictions. Thus, the concept of priority needs to be properly defined in the laws on registration. To merely state that one secured creditor has priority over another misses a significant generalization that is particularly important for real estate. If the priority is defined only in terms of financial relations relative to the collateral, the real estate registration regarding all rights will not work as it should.

Concomitantly, all rights in real estate must be registered in the same registry, so that the relative priorities of all the rights can be easily determined. Persons that desire to acquire rights in real estate need to know all of the outstanding rights against the real estate, including mortgages. Assume, for example, that an electric company would like to acquire a servitude across 3 meters of Blackacre for transmission line purposes. The electric company will search the real estate registry to determine not only who the owner is, but also to find out if there are any other right holders who should also agree to the servitude. If, for example, there is an outstanding registered mortgage, the electric company knows that, since the mortgage is prior to the servitude, the servitude can later be avoided if there is a foreclosure. In this case, the electric company will ask the holder of the mortgage to join in the grant of the servitude or subordinate its mortgage rights to the servitude. All mortgages, therefore,
must be discoverable by a search in the real estate records. It has already been shown that a name search is inadequate for this purpose. Consequently, it is unacceptable to set up a system where mortgages are registered in the movable property collateral registry.

Those systems that have separate registries for mortgages, as exist in some European countries, are less efficient than systems that register all the rights and encumbrances in the same registry, as in Australia, the United States, and many other countries, since one must look at two different registries and compare entry times to determine priorities between mortgages and other rights such as leases, servitudes and restrictions. Two separate inquiries, in two separate registries, lead to the greater chance of making an error in the search or failing to recognize the correct priorities. Therefore, all rights in real estate, including mortgages, should be registered in the same registry, namely the real estate registry.

KEEP MOVABLE AND IMMOVABLE REGISTRIES SEPARATE

For most rights in real estate the location on a particular parcel is significant. A servitude may be across the south 3 meters of the parcel. A mortgage may only encumber a part of the parcel. A lease may be only on a part of a building on a parcel. These rights must be linked closely with other cadastral information, especially the cartographic information. This suggests that all rights in real estate should be registered where the cartographic and cadastral information is maintained and updated. Movable property registries, where security interests are registered, but the objects of property and the ownership are not registered, do not allow for this. This is a strong argument for keeping the movable and immovable property registries separately. One may argue that the mortgages should be registered in both, but this unduly complicates searching and also introduces duplication and unreliability.

LOCAL REAL ESTATE REGISTRIES

There are also compelling arguments for keeping real estate records conveniently close to the location of the property. Where buildings belong to private owners, rights such as access to the building from public thoroughfares become extremely important. Also respective rights of owners of adjoining buildings over land between the buildings must be well defined. This is particularly important where one of the buildings does not front on a public street. Servitudes must be created for access and the information as to the existence and the validity of such servitudes must be a matter of convenient public inquiry. Under such circumstances national, centralized real estate registries are ill advised. This is in part, because most real property transactions involve, indeed require, an inspection of the premises by the Purchaser, lessee or lender. Persons desiring information regarding rights in real estate will certainly make their title searches at the local level. The information in the local registries will always be more current than information that is sent to and kept at a nationally centralized registry. Indeed it may even be counterproductive to maintain the real estate information nationally. The duplication of records will give rise to the possibility that the local databases and national databases do not match. The mere possibility that the records might be different will make it necessary to search both records for every transaction. If the records are inconsistent, an additional burden of determining which records to rely on will exist. Most likely, the local level records will always have to be searched, especially as to cartographic information and broader issues such as environmental restrictions, zoning laws and use limitations. It would be inefficient for investors to have to make inquiries other than those at the local level. An essential difference between movable property and real estate, namely that for movable property a debtor and the collateral might not be in the same geographic area and neither may be in the location that the collateral was originally given, argues for a nationally centralized registry system for movable property. The property might be located anywhere in the country and still be subject to outstanding collateral rights, which can be found if there is one national registry. Information that is location specific is not required. Only a simple name search will suffice to determine lenders’ priorities in the movable property.

Thus, the nature of the rights and the methods of search suggest that the registries for immovable property should be established at the local level, whereas registries for movable property should be centralized and national. Thus, they should not be combined.
CONCLUSION

It would be convenient if all types of collateral could be treated in the same manner, with the same rules, in a combined registry system. However, as has been shown, efficiencies don’t really exist between real property systems and movable systems, and the superficial similarities in the nature of mortgages and security interests do not compensate for the fundamental differences which compel a different treatment by lenders. On the contrary, the differences between mortgages and security interests account for the world practice of keeping these registries separate.