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# The Incompatibilities of the Secured Transactions Law Reform in Nigeria with Access to Credit: What Did the Lawmakers Get Wrong?

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## Abstract

In 2017, the Nigerian National Assembly passed the Secured Transactions in Movable Assets Act (STMA), which is predicated on the theoretical underpinnings of Article 9 of the U.S Uniform Commercial Code (UCC Article 9), precisely its unitary-functional approach to secured financing. The STMA claims that its overall aim is to expand access to affordable credit especially for individuals and small businesses. Yet, despite this laudable ambition, certain provisions of STMA significantly betray its aim and objectives, mainly due to the reformers ostensible lack of a proper understanding of STMA's ancestry, i.e., the UCC Article 9 and its case law jurisprudence that has developed over a period of seven decades. One of STMA's defects which largely ignore the realities faced by most of the small businesses and individuals in need of credit financing, is its requirement of them to provide an insurance cover as a precondition for concluding a valid security agreement. Similarly, its private enforcement mechanism which requires an advance notice as well as the unwise involvement of the Nigeria Police in repossession of collateral is problematic: this could be a fertile ground for more cases of police brutality and corrupt practices. Through a doctrinal analysis, comparing the STMA provisions with those of UCC Article 9, the paper shows how certain provisions of the former are inimical to its overall aim and objectives. The paper also suggests transplantable solutions that are likely to assist Nigerian lawmakers in reforming this important legislation.

## Keywords

Secured Transactions, Law Reform, Collateral Policing, Access to Credit, Insurance Cover, Collateral Registry, Borrower, Secured Creditor

# 1. Introduction: The Problems that Characterized the Legal Framework on Access to Credit in Nigeria Prior to the Reform in 2017

## 1.1. A Poor Appreciation of the Importance of Movable Assets in Accessing Affordable Credit

It has been a settled view among scholars of law, finance and economics such as (Macleod, 1876: p. 481; Gilmore, 1965: pp. 288-289; McCormack, 2011: pp. 597-625; 2004: p. 60; Gullifer & Tirado, 2017; Gretton, 2012: p. 278; Tajti, 2014: p. 178; Vig, 2013: p. 881), etc., that credit is the lifeblood of market economies. This view has now been widely subscribed around the world and motivated several reforms in the domain of credit law (Baxbaum, 2003: p. 332). The central aim of a secured credit law reform is to simplify the complexities of law in such a way as to accommodate the acceptance of all movable (personal) assets as possible collateral for securing debts or repayment obligations (Harris & Mooney, 1994: p. 2021; Kanda & Levmore, 1994: p. 2103; LoPucki, 1994: p. 1887; Picker, 1992: p. 645; Triantis, 1992: p. 225). Simplification of complex law vis-à-vis access to credit and "security" interests,[1] revolves around the unification of fragmented pieces of law that govern access to credit.[2] In this sense, unification of credit laws could be regarded as a synonym to the "functional approach" to security, which Article 9 of the Uniform Commercial Code (UCC Article 9) brought into existence (Bridge, Macdonald, Simmonds, & Walsh, 1999: pp. 572-575). Access to credit as is discussed in modern secured transactions literature could be regarded as a modern phenomenon that began with the important work of Grant Gilmore and his colleagues in the mid-twentieth century, which reformed the fragmented credit laws in the United States into a unitary-functional system (Schwartz & Scott, 1995: p. 595; Scott, 1994: p. 1783; Nickles, 1995: pp. 595-596; Rubin, 1993: p. 743; Gilmore, 1981: p. 625).

However, before the enactment of the STMA in 2017, the Nigerian credit laws in relation to movable assets were afflicted with complexities and fragmentations (International Monetary Fund, 2005), and each of the security devices, namely: mortgage,[3] charge, pledge and consensual lien, was governed by a separate sys-

[1]In *Edwards* v. *Flightline Ltd.* [2003] 1 WLR at 1200, the Court of Appeal defined "security" to mean an agreement between a debtor and a creditor that the debt owing shall be paid out of a specific fund coming to the debtor, or an order given by a debtor to his creditor upon a person owing money or holding funds belonging to the giver or the order directing such person to pay such funds to the creditor, will create a valid equitable charge upon such fund, in other words, will operate as an equitable assignment of the debts or fund to which the order refers. An agreement for valuable consideration that a fund shall be applied in a particular way may found an injunction to restrain its application in another way. But if there is nothing more, such a stipulation will not amount to an equitable assignment. It is necessary to find, further, that an obligation has been imposed in favour of the creditor to pay the debt out of the fund.

[2]See section 1 of the Nigerian Secured Transactions in Movable Assets Act 2017 (STMA). In this paper, unless otherwise indicated, all references to the word "collateral" or "asset" refer to movable assets which the STMA governs.

tem of law (Gullifer & Hurst, 2013: p. 685; Otabor-Olubor, 2015: p. 345). These caused the development of parallel and distinct bodies of jurisprudence that diminished clarity regarding applicable laws to security (Wood, 2010: p. 342; Iheme & Mba, 2017: pp. 131-153; Otabor-Olubor, 2017: p. 39). Prior to the legislative recognition of movable assets as an important category of assets for secured financing, secured lenders generally preferred immovable assets as collateral, because it reduced the chances of the so-called ostensible ownership whereby in the context of using movable assets as collateral, the borrower could in breach of a security agreement, present same collateral to other prospective and unsuspecting lenders or buyers: meanwhile, ownership in an immovable asset could less possibly be manipulated or used to fraudulently accumulate debts without arousing the awareness of the real mortgagee/secured lender due to the impossibility of moving such collateral outside jurisdiction (Schroeder, 1994: p. 399). However, in the case of using a movable asset as collateral), the chattel mortgagee/secured lender relies solely on the recordation of a collateral registry to discover encumbrances or prevent use of the collateral to obtain multiple financing in breach of agreement (Benjamin, 2010: p. 231; Calnan, 2015: p. 473). Yet, Nigeria lacked a national (Internet) collateral registry that could have served this purpose prior to the 2017 reform.

### 1.2. The Ostensible Ownership Problem Arising Mainly from Sale Credit Transactions and Lack of an Internet Collateral Registry

The Internet unarguably made movable assets more acceptable for securing repayment obligations: The National (Internet) Collateral Registry,[4] enables potential secured lenders or buyers of collateral to ascertain existing encumbrances on such collateral from across the globe (Gretton, 2012: p. 262). Before the UCC Article 9 popularized the acceptance of movable assets as collateral for secured financing, many market systems were already beginning to see the benefits of expanding access to credit through acceptance of a borrower's movable property as collateral (Hudson, 1995: p. 47; Schwartz, 1994: p. 2073). The Industrial Revolution that started in 1760s revealed the heightened efficiency of machines in producing more goods than could ordinarily be consumed on a cash-and-carry basis compared to when production of goods was exclusively from human labour. In order to balance consumption of goods with the increased level of machine production, taking consumer and sale credits were encouraged as a matter of necessity: this period saw the rise of consumer credits and acquisition financing such as hire purchase, credit sale, and pledge transactions.

All credit transactions require some element of trust that the borrower or consumer will repay at the agreed time: this explains why credit borrowing was initially reserved for trading merchants and hardly for individuals (Finch, 2017).

[3]In the case of Nigeria, chattel mortgage which draws from the Bill of Sale Act 1878-82 did not see the light of day due to the absence of a bill of sale register.

[4]The National Collateral Registry in Nigeria: https://www.ncr.gov.ng/.

While the repayment ability of a borrower ought to be a critical factor or a precondition for lending, producers and credit financiers who were pressured by the heightened level of machine production and the ensuing market competition started to pay little or no attention to the credit worthiness of borrowers.

The overwhelming appetite to expand production of goods through the aid of machines, challenged the existence of pledge as the oldest security device (Goode, 1989: p. 362; Smith, 2001: pp. 107-119). Pledge by nature, requires a secured lender to possess the collateral of the borrower for which he owes some duty to account (Parks, 1922: p. 174; Abasiekong, 1981: p. 73).[5] This debilitates the possibility or even the ability of the borrower to use the pledged assets to produce and make profits that will benefit all stakeholders (Goode, 1988: p. 10; Sykes & Walker, 1993: pp. 734-737; Palmer, 1991).[6] The outcome necessitated a practical shift from the prevalent use of the pledge security device to use of chattel mortgage which operates as a non-possessory security. Chattel mortgage entails registration of a secured lender's security *in rem* in the borrower's collateral (Glenn, 1939: p. 316). In the absence of the Internet, until sometime in the early period of the 21st century, collateral registries which harboured chattel mortgage registrations, were entirely physical, manually operated and required a potential secured lender to make physical visitations to such registries (Baird, 1983: p. 53). One of the limitations of this condition was the difficulty that surrounded paper or transaction filings, as well the impossibility of a secured lender staying outside jurisdiction or far away from the collateral registry to conduct checks.

The existence of collateral registries generally assisted secured lenders to discover pre-existing encumbrances in respect of a proposed collateral; however, the rate of success was reportedly insufficient due to the time lapse between the extension of credit and the completion of registration formalities: this was further perpetuated by the difficulties in navigating a huge avalanche of paperwork in the collateral registries.[7] The complexities and difficulties surrounding chattel mortgages occasionally climaxed into financial losses to secured lenders when their collateral was purchased by bona fide purchasers for value without notice (Whitney, 1933: p. 181; Rollison, 1993: p. 215; Smith, 2001: p. 304). The most important value of registration in the context of a chattel mortgage is the conversion of the secured lender's interest from an equitable status to a legal status. In many common law jurisdictions including Nigeria, a legal interest ranks above

[5]See *Matthew* v. *TM Sutton Ltd.* [1994] 4 All ER 793 where the court relied on equity and trust law to hold that a pledgee owes the duty to account for any surplus. Pledge as a method of perfection can also be undertaken through a constructive possession: see the explanations of the Privy Council in *Official Assignee of Madras v Mercantile Bank of India Ltd.* [1935] AC 53 at 58-59; *Labode v Otubu* (2001) 7 NWLR (Pt. 712) 256, where Mohammed Uwais CJN, generally expatiated on the security device.

[6]See section 8 STMA which does not recognize possession as a method of perfection of security interests except in the context of section 31, documents of title and negotiable instruments. 22.

[7]See Lord Templeman's explanation on the issues of registration formalities and complexities in *Sun Tai Cheung Credits Ltd.* v. *AG* (1987) 3 BCC 357, 361.

an equitable interest. Bypassing the forgoing challenges in a chattel mortgage transaction thus requires secured lenders to exploit the common law categorization of rights into legal and equitable.[8] This caused the creation and use of conditional sale which retains legal title in the seller or lender while the buyer or borrower in possession of the asset/collateral retains the equitable interest: the latter's interest gradually builds and eventually matures into a full legal title after the buyer or borrower has completed payment by instalments (Broude, 2001: p. 45).

The bypassing solution of conditional sale exposed potential secured lenders to the ostensible ownership problem that was occasionally exploited by borrowers in possession (Burdick, 1918: pp. 110-115). The creators of UCC Article 9 had to weigh the options presented by pledge which prima facie solved the ostensible ownership problem through possession of collateral as a system of perfection on one hand, and non-possessory security (chattel mortgage) which entails the retention of collateral in the borrower's hands with a security interest registration in it for the secured lender on the other hand (Calnan, 2006: p. 17). While registration of a security interest in a borrower's collateral could offer a suitable hierarchy that ensured repayment in the event of default or insolvency, the possibility that the borrower could destroy the collateral or remove it outside the jurisdiction of court, occasionally converted *in rem* security interests in such collateral to personal rights against the borrowers which was only capable of being satisfied through a court action. The forgoing challenges characterised the Nigerian legal framework on the use of movable assets to access credit until the enactment of the STMA.

### 1.3. Unification of Security Rights: From "Legal" and "Equitable" to a Unitary-Functional Security Right

The STMA, under section 63(1), did not follow the English common law categorisation of rights into legal and equitable: any form of right (equitable or legal) that a borrower has in a collateral is sufficient to create a security interest in it (Davis, 1997: p.145).[9] It merely assumes that a property right in any collateral that exists through an agreement which seeks to secure the payment or performance of an obligation qualifies as a security interest. As McCormack also explained, perfection and priority of security interests in such a borrower's collateral will be determined by their order of registration, and not by the time of creation or nature of one or more of the security rights (McCormack, 2003: p. 68). Arguably, however, section 2(3) STMA was conceived in error due to its retention of the CAMA floating charge, which naturally operates as an equitable device until its crystallization following the borrower's default or insolvency

[8]This categorisation exemplifies the title that may be passed. Presumably, an equitable interest holder cannot transfer a legal estate without the intervention of the court. The principles around *Savannah Bank v. Ajilo* (1989) All N.L.R. 26; *Jacobson Eng. Co. Ltd. & Anor. v. UBA Ltd.* (1993) 3 NWLR (Pt.283) p.586 and *Okuneye v. FBN Plc* (1996) 6 NWLR (Pt. 457) p.749 are illustrative.

[9]See the decision of the Supreme Court of Canada in *Royal Bank of Canada* v. *Sparrow Electric Corp.* (1997) 143 DLR (4th) 385.

(Gretton, 2003: pp. 313-314). The permission granted to incorporated companies under section 2(3) to continue to create fixed and floating charges ultimately brings back the jettisoned fragmented approach that characterised the pre-reform regime. The confusion that is likely to result from the conflation of the floating charge and the after-acquired floating security right of section 6(1)(b) STMA (equivalent of the U.S floating lien) is most explicit in the first to register or perfect rule which governs the STMA Act except in purchase money security interest (PMSI) arrangements under section 27 (Ngo, 2002: p. 85; Shupack, 1992: p. 767; Meyer, 2001: p. 143; Schwartz, 1989: pp. 250-254).

Notably, a floating charge remains an equitable interest until it has crystallized, whereas the STMA promotes the first to register in the collateral registry: thus if a secured creditor creates and registers a floating charge which enables the borrower to use the assets in the ordinary course of business, such a floating charge will only be enforceable against those assets when it attaches following a crystallisation (Gough, 1996: p. 135). Under the pre-reform system, his interest will be subservient to that of a secured creditor who subsequently created and registered an *in rem* security interest in those same assets: in respect of seniority of security interests, the pre-reform system cared more about the category of rights than the time of their registration (Goode, 2011; Gullifer & Payne, 2011: pp. 248-249).

However, following the STMA reform, the effect of section 2(3) on the forgoing scenario is that the floating charge holder who registered prior to the secured creditor's registered fixed charge, will rank higher the moment his floating charge crystallizes (attaches) on those same assets, due to the overarching section 23 priority rule that: where two secured creditors have security interests in the same collateral of a borrower and perfected via registration, the first to have registered will be deemed preeminent.[10] In that case, the doctrine of relation back applies to the effect that the floating charge which was registered first, but attached to the collateral later in time, will ascertain its priority based on the time of registration instead of the time of attachment: the combined outcome of sections 2(3) and 23 STMA is outrageous and is radically inconsistent with the understanding and effects of floating charges in Nigeria before the reform, as well as in the United Kingdom and United States from where some elements of the STMA were transplanted (Nguyen & Nguyen, 2014).

## 2. Some Diagnosed Defects of the Secured Transactions in Movable Assets Act 2017 and Proposed Solutions Based on a Comparative Study of Secured Credit Laws

### 2.1. A Banker's Superior Right of Set-Off

Under the UCC Article 9-104, a "bank account" is recognized as a collateral and can be perfected by "control", which is the equivalent of possession in respect of intangible assets (Walsh, 2015: p. 350; Weise, 2007: pp. 1633-1646). However,

[10]Section 23 STMA: "The priority between perfected Security Interests in the same Collateral shall be determined by the order of registration."

under the STMA, a bank account is not recognized as a collateral, and the Act did not expressly stipulate "control" as a method of perfection, even though functionally, it recognizes it under section 29: the section prioritizes a set off right of a financial institution over a perfected security interest that extends to the proceeds in the borrower's bank account. This means that a creditor's judgment which has attached to a borrower's movable assets (including money in bank account) through a writ of *fieri facias* will rank lower to a banker's financial claims against the proceeds in that borrower's deposit account. Similarly, in respect of other secured creditors other than the borrower's banker, the judgment creditor would have a lower priority ranking unless he complies with the stipulations of section 34 in respect of his judgment.

As it appears, section 29 has reduced the possibility of successfully recovering debts through a court action, due to the low ranking nature of a judgment debt over a banker's set off right: a borrower litigating in court could enter into a loan agreement with its bank in the terms that if he loses and thus required to satisfy a judgment debt, the situation will trigger the banker's right of set off against the proceeds in the borrower's bank account before the bank is ever requested to file any affidavit to show cause that the borrower keeps money with the bank. This appears to constitute a monumental defect of huge economic proportions.

### 2.2. The Invalidation of Non-Assignment Clauses

As earlier stated, the STMA has the ultimate aim of expanding access to credit by ensuring the use of movable assets to secure credit. The objectives are set out in Section 1 of the Act. However, Nigerian common law of contract is largely predicated on the doctrine of freedom of contract which allows capable parties to mutually agree on terms that will govern their contract. It is commonplace to see a non-assignment clause in many commercial contracts restricting each party from assigning their rights emanating from the contract to a third party unless the other party consents to the assignment. The rationale behind this rests on the privity of contract: for various reasons, parties are free to choose and insist on the identity of whom they contract with. Yet, while invalidation of a non-assignment clause under section 4(2)(b) and (3) is at the heart of achieving the STMA's overriding purpose, its operation appears to generally conflict with the notion of property right (McCormack, 2004: p. 13).

The ensuing conflict under section 4(2)(b) and (3) borders on the hierarchy between a right emanating from contract, the breach of which entitles the innocent party to remedies such as damages, specific performance and injunction; and a property right: inherent in the right to property is the power to alienate an interest in it, including to sell, destroy, make a gift or assign it for value. Bridge (2016), has commented elaborately on the theoretical underpinnings in respect of the possible conflict of property and contractual rights, yet the question that Nigerian courts might be required to settle at some point is whether a property right can be restricted by contract, especially if such a contract is adjudged adhesive? (Tajti, 2016: p. 245). Additionally, given that non-assignment of property

right emanating from contract has now been statutorily restricted under section 4(2)(b) and (3), the question of hierarchy of law might be pondered upon in fathoming a solution.

Apart from the seeming frictions from the notion of property rights, the use of non-assignment clauses in contract is rooted in the experience and possibility that a party could, in breach of the duty to notify before assignment of rights, assign them to a third party that is undesirable: in the event of default of the counterparty that has assigned, the third party assignee (i.e., the party that was assigned a portion of the accounts-receivable in the contract) will legitimately be an interested party, whose involvement diminishes the possibility of the original party's repayment in full.

Further, because the STMA highly encourages use of the National Collateral Registry as the principal system of perfection as stipulated by section 23, if a third party assignee of credit rights from contract registers in the Collateral Registry, his right *in rem* will be deemed perfected and thus rank higher than the original counterparty whose right after breach is *in personal* and only capable of being satisfied through a court action. Also, such a third party with a perfected right could pursue the self-help rights provided for under section 40 of the STMA. A possible solution for the restrictions imposed by section 4(2)(b) and (3) is that parties to a contract may have to register the possible net value of their credit rights in the contract in the Collateral Registry so that if a counterparty assigns their credit rights to a third party who proceeds afterwards to register a financing statement, the original contract party's right will remain preeminent on the basis of the STMA's first to register rule under section 23.

### 2.3. Distinct and Unlinked Collateral Registries

As earlier stated, the STMA depends largely on the National Collateral Registry as its system of perfection of security interests in borrowers' collateral. Unlike the UCC Article 9-609 and the UNCITRAL Legislative Guide on Secured Transactions that provide for possession as an equivalent of registration vis-à-vis the perfection of security interest rights (Kohn & Morse, 2016: p. 48), the STMA provides for possession as a method of perfection only for documents of title and negotiable instruments.[11] It will require a lot of sensitisation for individuals and MSMEs whose mode of doing business in Nigeria relies heavily on possession of assets (as in retention of title transactions) to recognise the important need to register each and every transaction. The monetary and logistical costs of registry search and registration for each transaction might significantly reduce the expected size of profit. This is worsened by the fact that section 5 of STMA requires that each security agreement as well as the underlying financing statement do indicate the amount of money covered by the credit transaction: the requirement fails to recognize the habit of regular small businesses and individuals in Nigeria who rely on retention of title at a scale that is not as developed as what is obtain-

[11]See sections 8 and 31, STMA.

able in the United States where the UCC Article 9 came from: yet Article 9-313 recognised this difficulty by ensuring that possession of goods or negotiable instruments is an equivalent method of perfection as registering a security interest in them because their possession furnishes notice to a potential dealer:[12] this proceeds from the Article 9 priority rule that where two or more security interests exist in respect of a collateral, priority amongst them will be determined by the first to have perfected or filed (Coenen, Givray, Quinn, & Hilton, 1977: p. 843).

Gilmore (1965: p. 463) was one of the principal architects of the UCC Article 9, and commented that "the typical pre-Code pattern included separate filing systems for chattel mortgages, for conditional sales, for trust receipts, for factor's liens and for assignments of accounts receivable. In such a situation the expense and difficulty of making a thorough credit check are obvious. Since the filing requirements were themselves frequently obscure and tricky, the chances were good that a lender who, through his counsel, was familiar with one device would inadvertently go wrong in attempting to comply with another and fail to perfect his security interest". In Nigeria, however, the STMA reformers did not remember the importance of linking the various collateral registries that were in place prior to its enactment. For instance, the Company registry, which is managed by the Corporate Affairs Commission (CAC), came into existence with the Companies and Allied Matters Act 1990, and has been a depository for floating and fixed charges registered against corporate assets. Yet, section 2(3) of the STMA preserves the power of corporations to create charges that are registrable at the CAC registry, thus endorsing the existence of both the CAC registry and National Collateral Registry (Esangbedo, 2020: pp. 81-105; Bennett, 2003: p. 217). Similarly, there is also the existence of intellectual property (trade mark) registry where licenses and assignment of interests in trademarks are registered.[13] A trademark, being an intangible movable asset for which the STMA governs,[14] any encumbrances or perfection of interest in relation to their use as collateral ought to be registered at the National Collateral Registry. The forgoing is also true with the different motor vehicle registries where details of ownership are documented.[15] The challenge therefore is the multiplicity of registries governing different types of movable assets and the resulting confusion on a potential creditor in knowing exactly where to search for pre-existing encumbrances: unfortunately, the STMA did not provide specifically for the unification of these distinct registries. As (Fleisig, Safavian, & de la Pena, 2006: p. 39) rightly opined, multiple registries diminish the realisation of credit access.

[12]See *Official Assignee of Madras v Mercantile Bank of India Ltd.* [1935] AC 53 Privy Council (the court explained how possession creates a similar type of notice that is achievable also by a collateral registry).

[13]The registry is managed by the commercial department of the Ministry of Industry Trade and Investments. Available at http://www.iponigeria.com/

[14]See Section 2(1) STMA.

[15]For the vehicle registry in Abuja, see (https://fctevreg.com/aboutus.htm); and for Lagos, see (http://www.lsmvaapvs.org/; https://lagosstate.gov.ng/blog/2017/07/05/lagos-and-motor-vehicle-administration/)

To be on the safe side, a potential secured creditor might be forced to search all known collateral registries in respect of a particular movable asset: this will be costly in terms of money and time, and the high cost might eventually be transferred to the borrower as part of the credit. On the part of the borrower, this situation will ultimately diminish the realisation of the objectives of section 1 STMA towards expanding access to affordable credit, which will negatively affect the borrower's competitiveness in the market, including the risk of becoming insolvent. On the part of the secured creditor, the multiplicity of collateral registries might lead to a loss of seniority if he was unable to search in all the relevant/specific registries for existing encumbrances (Estrella-Faria, 2009: p. 16). The open-ended possibility to create collateral registries in respect of the different types of movable assets will thus lead to confusion and uncertainty, as well as whittle the interest of potential creditors in advancing affordable credit, especially those creditors that had consequently suffered losses in their past transactions. Both UCC Article 9 and the UNCITRAL Legislative Guide on Secured Transactions recommend the unification of registries into one known collateral registry: this can be done by linking the databases of the various collateral registries into a single database to enable searchers or potential creditors know of existing encumbrances in respect of a borrower's collateral (Lipson, 2005: p. 426). Given the intensity and prevalence of internet services in Nigeria, these linkages enjoy the highest level of possibilities.

### 2.4. Collateral and Debtor-Policing: A Necessity Borne out of the After-Acquired (Floating) Security Right

Before the STMA reform in 2017, the knowledge and use of floating security in Nigeria was exclusively confined to floating charges.[16] The floating charge device was created by the English courts in the 19th century.[17] And at common law, a registered floating charge is considered to be of equitable nature (Oditah, 1991: p. 49), while a fixed charge is considered to embody a legal right upon registration.[18] In the case of a registered floating charge, its ability to confer a legal title is postponed until crystallization, when it converts itself into a fixed charge and enables its holder to appoint a receiver or administrator (Pennington, 1960: p. 630; Goode, 1997; Gullifer, 2008: p. 419). The English floating charge was exported to many common wealth (former British colonies) as part of the common law package, with the exception of the United States whose courts refused its admission into American legal system.[19]

The outright rejection of the floating charge by the U.S courts was extensively documented in *Benedict v Ratner* (1925) and similar cases where some Ameri-

[16]Defined in section 203(1) of Companies and Allied Matters Act (CAMA), 2020.

[17]see *Illington v. Houldsworth* [1904] AC 355; *Agnew v. Commissioner of Inland Revenue* [2001] 2 AC 710; *Re Spectrum Plus Ltd.* [2005] UKHL 41, p. 106.

[18]Sections 202-205 CAMA, 2020.

[19]See *Benedict v Ratner* (1925) 268 US. 353, where the court expressed concerns that leaving collateral assets in the hands of the debtor unfettered will likely lead to a fraudulent misuse.

can judges lamented about the floating charge's high propensity to encourage credit fraud by leaving the debtor to have an unfettered dominion over the encumbered assets: its inherent feature to leave encumbered collateral in the hands of the borrower, to use and dispose of them in the ordinary course of business, propagated the existence of the so-called ostensible ownership problem whereby dubious borrowers sold such collateral to unsuspecting buyers. In fact, *In re Portland Newspaper Publishing Co.* [1966], the court specifically stated that the fraud on accounts would have been prevented if the collateral had been policed.[20] In retrospect, judging from the existence of the U.S floating lien (a close kin but hardly the equivalent of a floating charge), it is understandable why floating charge elicited so much fear among American judges at that time (Carroll, 1967: p. 243). For the floating lien which came with the UCC Article 9, there was no differentiation between a human borrower and a corporate borrower.[21]

However, in the United Kingdom, the floating charge is only capable of being created by corporate borrowers. This restriction prevented a large scale exploitation of the floating charge due to the fact that a corporate borrower enjoying the permission to deal with encumbered assets (present and future) in the ordinary course of business, is more regulated and had more difficulty in disappearing from the system compared to its human counterpart. Yet, regardless of the risk of misuse, floating charge was the only way of using inventories (shifting assets) to secure a repayment obligation: fixed charge proved commercially impracticable in this regard due to the inherent obligation to inform a fixed charge holder before removing encumbered assets or dealing with the charged assets in a manner that breached the security agreement. Imagined with inventories (e.g., goods for sale on the shelves of a supermarket), assuming the obligation to inform a fixed charge creditor before the goods are ever sold and taken away from the supermarket remains impracticable, even though it is possible in principle as explained by the UK Privy Council in *Re Brumark Investment Ltd*.[22]

In Nigeria, floating charge (still in existence and operation) has been for the exclusive use of corporations since its adoption with the English common law and more precisely enshrined in the various versions of the Companies and Allied Matters Act:[23] thus bulk of the experience so far vis-à-vis a floating security resides in corporations and their secured lenders until the 2017 STMA reform.[24]

[20](1966) 2 Bankr. L. Rep. (4th ed.) 11 6172, at 71136.

[21]The After-acquired and future advances clauses of the UCC Article 9 can be found in its Sections 9-108, 9-204, and 9-205.

[22][2001] UKPC 28. Also known as: *Agnew v. Commissioner of Inland Revenue* [2001] 2 AC 710.

[23]See sections 202-205 CAMA 2020.

[24]See the Nigerian Court of Appeal and Supreme Court explanations on the various implications of floating charge based on the erstwhile CAMA 1990: Intercontractors Nigeria Ltd v. UAC [1988] *2 NWLR* (*Pt. 76*), *303*); Intercontractors Nigeria Ltd v. N.P.F.M.B. [1988] *3 NWLR* (*Pt. 76*), *280* (*SC*); Uwakwe & Ors v. Odogwu & Ors [1989] *LPELR-3446* (*SC*); Fadeyibi v. I.H (Beverages) Ltd. [2009] *5 NWLR* (*Pt. 1135*), *446 C.A* (*the cases basically discuss the fiduciary duties of a receiver and his powers in taking over assets of a company, even though the title of those assets remain in the company*).

Section 6(1)(b) of the STMA creates a type of floating security that embodies the features of both fixed and floating charges, a sort of hybrid security that attaches to a borrower's assets from the beginning upon entry into a valid security agreement with a secured creditor (Kronman, 1975: p. 119). The principal difference between a floating charge (governed by the Companies and Allied Matters Act) and the Section 6(1)(b) after-acquired (floating) property security right (equivalent of the U.S floating lien) is that while creation and use of the former is only reserved for corporate borrowers, the latter could be created by both a corporate and human borrower.

While use of the Section 6(1)(b) after-acquired property (floating) security right by a human borrower conforms largely with the purpose of STMA towards expanding access to credit by accommodating the use of shifting assets of human borrowers as collateral, the problem and fraud concerns imagined by the U.S courts in *Benedict v Ratner* and its line of cases in respect of a floating security have become present in Nigeria given the recent ability of human borrowers/debtors to create it over their assets. That problem borders on the high probability of disappearance of a roguish human borrower after his accumulation of so much debt in exchange with a floating security interest in his present and future assets, for which he is authorized to use and dispose in the ordinary course of business. According to the 2020 Corruption Perceptions Index by the Transparency International,[25] Nigeria ranks 149/180 in comparison to the United States which ranks 25/180:[26] in other words, the section 6(1)(b)-type of security stands a higher chance of success in the United States (where it was imported from) than in Nigeria.

The UCC Article 9 recognized the possibility of this problem and provides a solution, although not textually included in Article 9-205, but stipulated in its Official Comment.[27] The solution is contractual instead of statutory: secured creditors who are concerned of the possibility of fraud arising from a floating lien security, can agree to enjoy the right to police the borrower and his collateral in their security agreements. Thus, where a policing right is included, the secured creditor will have the right (equivalent to the policing rule in *Benedict v Ratner*) to monitor the borrower as well as the collateral to prevent fraud or misuse such as sale of it without any equivalent replacement: a policing right enables a secured creditor to diagnose the borrower's fraudulent behaviour early in time, which could become a ground for default or accelerated enforcement of security. Just like in the United States, the possibility of a creditor to police a borrower or his collateral could eventually result to the birth of a policing industry: i.e., professionals acting as collateral policing agents can obtain a power of attorney to monitor the borrower and their collateral and report any develop-

[25]Corruption Perceptions Index 2020 by the Transparency International. Available at https://www.transparency.org/en/cpi/2020/index/nga

[26]Ibid, at: https://www.transparency.org/en/cpi/2020/index/usa

[27]Article 9-205 abolished the former statutory right rooted in *Benedict v Ratner* to police a debtor or his collateral. As the Official Comment to Article 9-205 explains, this right can only arise per an agreement of parties.

ment that is inconsistent with the terms of the underlying security agreement.[28]

Because the STMA was transplanted by lawmakers who ostensibly lacked awareness or a thorough understanding of the original source of STMA (i.e., the UCC Article 9), the right (statutory or contractual) to police a debtor or his collateral was omitted in the STMA. Even though the omission was perhaps due to lack of a comparative knowledge of secured credit laws, the absence of a collateral-policing right could legitimately be argued to be a conscious omission on the basis that legislators know the law, operate consciously, and whatever that is not provided in a legislation is not authorized and therefore illegal.[29] Given that the STMA provides for a self-help repossession under section 40, the right to police a borrower or his collateral is not inherently outrageous: if anything, it will save the STMA from failure because of the high probability for borrowers to negatively exploit Section 6(1)(b) after-acquired (floating) security right by accumulating so much debt in respect of collateral and thereafter relocate to another part of Nigeria with those assets.

The lack of a national database where the personal data of all Nigerians or passport holders are recorded and shared by the law enforcement agencies and banks might encourage a dubious exploitation of the Section 6(1)(b) floating security. Moreover, in deference to the views expressed by secured transaction scholars such as (Stacy, 2014; Fleisig, Safavian, & de la Pena, 2006: pp. 23-24) "that an obsolete law that governs secured transactions makes it difficult to use property as collateral, raising hurdles in each stage of the process: creation, publicity and enforcement of the security interest, and those legal regimes should not make needless restrictions on creating security interests, excluding economically important property, agents and transactions", if the STMA aims at expanding assess to credit and curing poverty in Nigeria by ensuring an ease of doing business, requiring Bank Verification Numbers (BVN) and national passports as preconditions for entering into a security agreement for which the STMA governs will seriously attack the overall purpose of the statute since only about 35% of Nigerians are banked and able to provide BVNs.[30] Half of the Nigerian people live in rural areas constitute more than 40% of them do not have BVNs (Nwachukwu, 2020). Consequently, they will likely be denied the benefits of the STMA. Arguably, there is a need for a textual amendment of the STMA to include a right to police a borrower or collateral, so that a secured creditor who polices a collateral or borrower to ensure against fraud or misuse of collateral will not run the risk of engaging in some illegality: preserving collateral and ensuring against loss of secured creditors' investment is needed in realising the

[28]See Repossession Services Industry in the U.S, Market Research Reports (March 2020) IBIS World, https://www.ibisworld.com/united-states/market-research-reports/repossession-services-industry/; Also see the American Recovery Association Inc., https://repo.org/ (accessed 10 January 2021).

[29]*Awolowo v. Shagari* (1979) All NLR 105.

[30]See:http://finclusion.org/uploads/file/reports/2016%20Data%20at%20a%20Glance%20Financial%20Inclusion%20in%20Nigeria.pdf (Accessed 10 January 2021).

overall purpose of the STMA.

However, section 6(1)(c) provides a form of solution by mandating that a security agreement must contain a description of the details of insurance over the borrower's collateral. In principle, mandating an insurance cover to protect the security interest of a secured creditor over floating assets is adequate: however, this will entail too much burden on the Nigerian insurance companies. Also, the requirement for an insurance cover as a precondition for validity of security agreements is outrageous and does not conform to the situational realities in Nigeria where a large number of those categorized as MSMEs or individuals do not have the financial resources, educational or organisational competences to process and obtain adequate insurance covers (Esangbedo, 2018: p. 3). MSMEs engaging in secured transactions on a daily basis would hardly be in a position to process insurance covers before entering into their numerous transactions: the population of Nigeria is over 200 million people and if all those engaging in secured transactions were to first apply and obtain an insurance cover, the high number of insurance applications will overwhelm the number of insurance companies that are currently in existence, and the slow processing of applications will make difficult as well as delay the timely conclusion of security agreements (Oliyide, 2012: p. 653).

The practical outcome of section 6(1)(c) will impede the growth of small businesses and thus defeat the ultimate purpose of section 1 to expand access to credit and cure poverty: undeniably, the cost of insurance premiums under Section 6(1)(c) will eventually be borne by borrowers. Similarly, given the lack of adequate awareness of the STMA in the small business community, noncompliance with the Section 6(1)(c) insurance requirement will make a security agreement void and unenforceable against the borrower either upon default or insolvency: secured creditors that are lucky to be aware of Section 6(1)(c) will likely insist that the borrower procures an insurance premium as a precondition for obtaining credit. In the author's opinion, the STMA needs to be amended to remove the operation of Section 6(1)(c), and could be replaced with a more practicable solution such as a policing right against a collateral or borrower: this will simultaneously require a textual amendment of the section 40 ten-day notice, which currently operates as a precondition for repossession. Moreover, the few insurance companies in Nigeria are not financially able to cater for too many defaults that are likely to arise from the population of over 200 million people especially during a credit crisis such as the COVID-19 pandemic situation: Section 6(1)(c) therefore appears to be a sort of regulatory capture by the insurance industry given that the 6(1)(c) provision was a last minute addition judging from its absence in the bill that was debated on the floor of the National Assembly up to the third reading.

### 2.5. Enforcement of Security Interests through Self-Remedy: An Unreasonable Involvement of the Nigeria Police Force

In the pre-STMA regime, the Nigerian legal system lacked a statutory self-help

mechanism for enforcing security interests in borrowers' collateral, except in the context of a hire purchase agreement where the hirer has failed to repay two or more instalments, thus enabling the owner to remove the motor vehicle to a premise he has control for the purpose of preserving the asset from damage or deterioration.[31] Apart from the hire purchase situation, every enforcement of security in movable assets (in the pre-STMA regime), generally required a judicial enforcement: the enormous cost that was typically involved in recovery meant that individuals and MSMEs respectively in need of small credit amounts either for personal consumption or business experienced difficulty in convincing secured creditors to lend. The attitude of the Nigerian Supreme Court in relation to self-help repossession has been that of outright rejection, and it grew out of the experiences of the 20th century Nigerian military rule whereby the use of self-help even by government agencies was prevalent.[32] Also, the average litigation period for a matter at the court of first instance is between five and seven years, and will of course be higher if a party decides to appeal decisions up to the Supreme Court (Iheme & Mba, 2017: p. 138). Given the high costs of judicial recovery, it made good commercial sense to only lend to rich individuals and corporate borrowers with adequate assets, and whose credit transactions could generate enough profit to offset the time and cost in judicial recovery.

The STMA provides a solution (although insufficient) to the forgoing challenge through its section 40 repossession provision: the wisdom of self-remedy in realizing security interests in movable assets is traceable to the UCC Article 9-609 which as far back as 1952, commenced authorization of a secured creditor to repossess its borrower's collateral upon default without the breach of peace. The "without the breach of peace" exception under Article 9-609(b)(2) has received varying judicial interpretations over several decades (McRobert, 2012: p. 569). The *ratio decidendum* from the body of case law vis-à-vis the exception, is that where a borrower physically objects to a repossession during the act, the secured creditor cannot afford to proceed to recover the collateral without being adjudged to have breached the public peace (Korybut, 2014: pp. 279-333). In the U.S., a repossession industry has emerged from the repossession provision of

[31]See section 9(5) Hire Purchase Act, 1978 (Nigeria).

[32]See: *Ellochim Nigeria Ltd and Others v Mbadiwe* [1986] NWLR (Pt. 14) 47 at 165, where the court said: "It is no doubt annoying, and more often than not, frustrating, for a landlord to watch helplessly his property in the hands of an intransigent tenant who is paying too little for his holding, or is irregular in his payment of rents or is otherwise an unsuitable tenant for the property. The temptation is very strong for the landlord to simply walk into the property and retake immediate possession. But that is precisely what the law forbids." Although the decision was repealed in *Awojugbagbe Light Industries Ltd. v Chinukwe* (1995) 4 NWLR (Pt. 390) 379, no coherent framework on self-help exists. Also see *Ojukwu v Military Governor of Lagos Sate* [1985] 2 NWLR (Pt. 110) 806, where self-remedy was roundly rejected. Also see *Civil Design Construction Nigeria Ltd. v SCOA Nigeria Ltd.* [2007] 6 NWLR (Pt. 1030) at 300, where the Supreme Court voiced a similar condemnation. The Nigerian Supreme Court has contradicted this position in a number of its decisions. See *Umeobi v. Otukoya* (1978) 1 LRN 172; Nkume v. RTDN (1998) 10 NWLR (Pt.570) 514.

Article 9-609:[33] experienced professionals who have carefully studied the opinions of judges in repossession cases undertake repossession more effectively and therefore reduced the rate at which borrowers mistook repossessing creditors as robbers and fatally shooting them (Iheme, 2013). In the case of motor vehicle collateral which is a common type of collateral for securing credit, repossessing agents typically monitor the movement of defaulting borrowers until they can safely repossess collateral without confrontations or any act that could be interpreted as breaching the public peace (Meadows, 1994: p. 167).

Under the STMA, section 40, unlike the UCC Article 9-609 equivalent, requires a secured creditor intending to repossess to furnish a ten days' notice prior to repossession of collateral. Arguably, a ten-day notice before repossession of the borrower's collateral as required by section 40 is likely to result into a failure of repossession: the borrower could before the lapse of notice, transfer the collateral outside jurisdiction or sell it to an unsuspecting third party especially if the collateral is part of the fold governed precisely by a section 6(1)(b) floating security which allows a borrower to use and dispose assets in the ordinary course of business. In effect, the notice provision under section 40 whittles the effectiveness of the proposal to grant a statutory right to a secured creditor to police a borrower or his collateral.

Also, if in compliance with section 40, a secured creditor furnishes a ten-day notice and the borrower transfers the collateral outside jurisdiction, sells, or destroys the collateral before the lapse of notice, the remedy of the secured creditor in the circumstance would be to pursue the insurance company for payment, which could entail litigation. The insurance company might thereafter pursue the borrower in litigation if the latter's act did breach the insurance agreement: in any case, borrowers who paid insurance premiums could possibly sell their collateral to offset the premium costs. This could result in the secured creditor's chase after the insurance company through litigation. The forgoing experiences will likely lead to higher premium charges for insurance covers as well as higher interest rates for credit, which will generally be unaffordable for individuals and MSMEs and therefore defeat the STMA's overall aim of expanding access to credit in Nigeria.

Undoubtedly, the above challenges are occasioned by the notice provision under section 40 as well as the insurance requirement of section 6(1)(c), and a possible remedy is to retrace steps back to the UCC Article 9: in other words, the requirement for insurance cover should cease to be a precondition for entering into a valid security agreement under the STMA. Similarly, and based on the rich experiences of Article 9 case law, repossession of collateral is most effective if the surprise element is retained: i.e., upon default, the borrower ought not to be notified about the creditor's intention to repossess.

In *Ocean Securities Ltd v Balogun & Ors*,[34] the Nigerian Court of Appeal held

[33]See https://www.ibisworld.com for the Repossession Services Industry in the US, Market Research Report: Updated August 23, 2021 (accessed on 20 April, 2022).
[34][2013] All FWLR 633.

that the police force should not be used in debt recovery: the duty of the police is to enforce the law and not private contracts. Thus, another defect of the STMA is the authorization of the secured creditor to use the Nigerian police force in collateral repossession.[35] This approach was perhaps motivated by the prevalent use of the police in Nigeria to intervene or enforce civil and criminal matters out-of-court: authorizing the use of police to repossess collateral in a country that is still recovering from the 29 years cumulative period of military rule, and where police brutality is still commonplace, is to statutorily reinforce its occurrence and possible use against defaulting borrowers, since in most cases the Nigeria police basically act as mere agents of their complainants who could utilise them to effect wrongful arrests or brutality of anyone they perceive as their opponents (Human Rights Watch, 2007; Uwazuruike, 2020).

### 2.6. The Error in Preserving Pre-STMA Credit Transactions

The STMA states that "security interests in movable assets created before the coming into effect of this Act shall continue to remain valid and effective on the terms and conditions agreed to by the Grantor and Creditor."[36] In many democratic countries, the parliament is not generally authorized to make retroactive legislation as it could potentially defeat predictability and rule of law. However, this rule is not cast-in-stone and could accommodate exceptions in egregious circumstances (Smead, 1936: pp. 778-783). While section 62 preserves preexisting security agreements in deference to the sanctity of contract doctrine, it simultaneously leaves a gap that could be negatively exploited in bypassing the stringent requirements of the STMA and thus defeat the essence of the reform, if contractual parties are able to simply backdate their security agreements with a date prior to enactment of the STMA.

The forgoing concern of section 62, proceeds from the thorough observations made by Nwabueze (2009: pp. 59-89) in respect of the Nigerian Land Use Act 1978, which exempts or does not apply to land transactions concluded prior to its enactment. In the case of the Land Use Act (in addition to the onerous requirements for registration and perfection of title), its section 22 requires the obtainment of a governor's consent as a precondition for an alienation of interest in land.[37] The Stamp Duties Act also imposes its conditions that disable an unstamped land document from being tendered in evidence.[38] In many parts of Nigeria, conveyancers "routinely resort to powers of attorney and agreements to sell (estate contracts) as tools to avoid the prohibitory clauses of the Land Use" (Nwabueze, 2009: p. 59). This is typically achieved by backdating their agreements with a date prior to the enactment of the Land Use Act.

In reference to the STMA, if contractual parties start to mimic the practice of some land conveyancers by backdating their security agreements as a bypass to

[35]See section 40(6) STMA.

[36]Section 62, STMA.

[37]See *Savannah Bank of Nigeria Ltd vs. Ajilo* (1989) ALL N.L.R. 26 at 42.

[38]Section 22(4), Stamp Duties Act, CAP 441 LFN 1990.

the stringent provisions of STMA, the outcome will defeat the overall aim and objectives under section 1, which aims precisely at expanding access to affordable credit, because of the possibility of continuing to import the former regime into existence through the section 62 provision.

## 3. Conclusion: The UCC Article 9 as an Important Source of Solutions

The overall aim of reforming the legal framework on secured transactions in movable assets through the STMA, is as stipulated under its section 1, to expand access to credit to individuals and small businesses by removing the obstacles that plagued the pre-reform regime. Yet, some of the provisions of the STMA are defective and incapable of realizing the overall aim of the reform. The UCC Article 9 was the first modern secured transactions law that formally came into existence in 1952: its provisions have influenced reforms in many common law and civil law systems *(Cohen, 1999: p. 423; Drobnig, 1977: p. 171; Garro, 2003: p. 357)*. Also, the UNCITAL Legislative Guide on Secured Transactions, Book IX of the Draft Common Frame of Reference (DCFR),[39] UNIDROIT Model Law in the General Field of Secured Transactions,[40] EBRD Model Law on Secured Transactions,[41] etc., are few of the model laws that drew inspirations from the UCC Article 9 *(Tajti, 2013)*.

While there is hardly any mention or acknowledgment of the relationship between the STMA and UCC Article 9 by the Nigerian lawmakers, the nexus between the UCC Article 9 and STMA is undeniable: the former being over seventy years old had at least indirectly inspired the creation of the STMA. Thus, even if not verbatim, some of the provisions of the STMA can functionally be traced back to the UCC Article 9, as well as the UNCITRAL Legislative Guide and similar other model laws. However, UCC Article 9 is a law in practice and has garnered judicial decisions for almost every of its provisions since the last seventy years of existence. This paper therefore proposes an in-depth study of UCC Article 9 and its judicial precedents by the Nigerian lawmakers, judges, academics and students, to enable them understand how best to reform the STMA. Also, in case of doubts in respect of the meaning and effects of the STMA provisions, Nigerian courts as well as the business community can study the rich body of case law that has developed around the Article 9 provisions.

By being influenced by these practices and decisions, Nigerian regulators, financial institutions and the business community will be able to optimally apply

[39]The text of DCFR can be downloaded from http://ec.europa.eu/justice/policies/civil/docs/dcfr_outline_edition_en.pdf.

[40]The UNIDROIT text on secured transactions is freely downloadable at https://www.unidroit.org/studies/security-interests/407-study-lxxii-a-model-law-in-the-general-field-of-secured-transactions

[41]The EBRD text is freely downloadable at https://www.ebrd.com/news/publications/guides/model-law-on-secured-transactions.html

the legislative utility streams induced by STMA. In summary, therefore, it is suggested that STMA be subjected to further legislative action in the context of the lapses highlighted above. Specifically, sections of the law dealing with repossession, insurance, role of the Nigeria Police Force, pre-repossession notice, and statutory authorization to link National Collateral Registry with other existing registries should be reviewed with a view to promoting transactional beneficiality and legitimacy within the STMA regime.

## Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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