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PRELIMINARY STUDY OF GUARANTEES AND SECURITIES AS RELATED TO INTERNATIONAL PAYMENTS

Comparative Survey of Security Devices under National Laws*

Report of the Secretary General

Addendum

1 The need for devices securing credit and loan transactions by means other than pledge and mortgage[1/] arises in particular in countries where an expanding economy requires sources of credit that are adapted to modern commercial relations. A diversified system of securities is thus primarily a feature of the legal systems of developed countries, although by no means of all.[2/] Some developing countries,[3/] however, have recently enacted laws permitting security transactions in certain limited areas for the purpose of assisting the growth of a particular sector of the national economy.

2. In most countries, developed as well as developing, the approach to securities has, on the whole, been piecemeal and fragmentary. Often this approach was, and still is, predetermined by existing legal principles which, in so far as they constitute the framework within which the system of securities evolved, tend to obstruct rather than assist the creation of security instruments that would meet present day requirements

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(*) See document A/CN.9/20, paragraph 20, footnote 25.

1/ Understood here in the civil law sense, i.e. pledge (gage, prenda) of movable (tangible and intangible) property (personality), and mortgage (hypothèque, hipoteca) of immovable property (reality).

2/ In socialist countries, where the means of production and the financial institutions are government-owned, there is less need for security devices in domestic transactions.

3/ See list of countries listed in footnote 6.

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3. A comparative study of the relevant law and practice[4/] shows a considerable variety of security devices which differ both in form and in substance. It may suffice, for the purpose of the present report, to give a brief survey of those that are most widely used and to indicate, where appropriate, the main characteristics of each and the legal effects they entail.

(a) Pledge without dispossession and chattel mortgage

4. In most civil law countries, the legal framework of securities has been based largely on the notion of pledge. Since the traditional pledge involves dispossession of the pledgor and is therefore not always a convenient means of securing credit in modern business practice,[5/] the solution in most countries has been to permit the pledgor, by way of legal exception to the general principle and in transactions defined by law, to retain possession of the pledged goods. The result is a pattern of security laws, each creating a special form of pledge

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4/ Certain forms of security are, in some countries, not regulated by law but have been developed by commercial practice and case-law, e.g. fiduciary transfer of property in Germany, Indonesia and the Netherlands and, in many countries, conditional sale.

5/ E.g. in cases where credit is sought to acquire capital goods in order to develop a commercial, industrial or agricultural activity. In these circumstances, the debtor will obviously wish to utilize the goods for that purpose. This will, at the same time, enable him to pay his creditor. Pledge involving dispossession would defeat the purpose of the credit transaction.

without dispossession and having a limited scope of application.6/ By way of example, under the French law of 18 January 1951, machinery and capital goods may only be pledged for the purpose of financing their purchase; under the law of Argentina only certain persons may be pledgees, e.g. Government agencies, banks, registered loan establishments, merchants or industrialists as regards the goods they sell or manufacture. Such pledges can be compared to the chattel mortgage of the common law in that they both create a security interest in favour of the creditor without involving the transfer of the goods.

6/ Thus in France there have been created, by law, a series of special forms of pledge without dispossession of the pledgor (nantissements sans dispossession, warrants spéciaux), such as nantissement du fonds de commerce (law of 17 March 1909); nantissement des véhicules automobiles (law of 29 December 1934); nantissement des films cinématographiques (law of 22 February 1944); nantissement de l'outillage et du matériel d'équipement (law of 18 January 1951); warrant agricole (law of 18 July 1898); warrant hôtelier (law of 8 August 1913); warrant pétrolier (law of 21 April 1932); warrant industriel (law of 12 September 1940). An identical situation obtains in Belgium (privilège agricole, gage du fonds de commerce, warrant charbonnier), Luxembourg (warrant agricole, gage sur fonds de commerce) and Italy (privilegio agrario, privilegio sugli autoveicoli, privilegio del venditore di macchine). Korea permits a special pledge on machinery, factory equipment and installations; Finland on industrial property and agricultural movables; Norway on grain, timber, floating docks and oil drilling rigs; Quebec on machinery and equipment; etc. Within this group fall also most countries in Latin America that have enacted agricultural pledge laws (prenda agraria, prenda or peñhor agricola) and industrial pledge laws (prenda industrial), by virtue of which industrial or agricultural assets, installations and machineries, tools, utensils, animals, raw materials and products of any exploitation which have been industrially transformed may serve as security for obligations acquired in the line of industrial or agricultural business; such pledges may be specific or floating. See Folsum, Chattel Mortgages and Substitutes Therefor in Latin America, Am. Journal of Comp. Law, vol. 3 (1954), pp. 477-491.

5. Although the detailed provisions of these pledge laws often differ, sometimes even within the same country, such laws have the following common features:

(i) for the pledge to be valid against third parties, it must be in writing[7] and registered in an official register;[8]

(ii) the pledgee acquires a priority (privilège) over other creditors[9] and the assignee in bankruptcy in respect of the goods pledged;

(iii) in the event of default of the pledgor, the pledgee may sell for the account of the pledgor;[10]

(iv) as a rule, the pledge is valid only if it secures the transaction specified by the relevant law.

7/ Often, certain formalities are required, e.g. the written document (which is in some countries a special form issued by the Administration) must be signed by third persons. As a rule, the pledged goods must be itemized in the written document or deed and described in detail. It is sometimes also required that the document indicates the place where the goods are located and that an indelible plate be fixed on the pledged material.

8/ Registration thus replaces, in French law and similar legal systems, the possession vaut titre principle.

9/ But it is sometimes provided that notice of the pledge must be given to other holders of a security interest (e.g. the mortgagor if the goods have become immovable by incorporation or destination) and that in the absence of such notice the priority right will be void against such holders. See, for instance, the French Act of 1951 regarding the pledging of machinery and capital goods Article 9(3).

10/ Usually after having obtained judgment against the pledgor. In some countries the pledged property can only be sold under judicial supervision.

6. In contrast to the system described above of pledges that can be used in particular cases only, the common law countries have conceived a more general system in that the use of chattel mortgage is not conditional on a specific transaction, the object of which is a specific commodity. By a chattel mortgage on movables, the mortgagee acquires, by way of security, a legal interest in the property of the mortgagor (in whom beneficial ownership is vested) which is valid against the latter's creditors. The mortgagee has the right to foreclose or sell the goods in the event of default of the mortgagor but only after having given the latter the opportunity to redeem. The mortgagor, apart from his equity of redemption, has the right to have the chattel reassigned after having discharged his obligations.

7. In most common law countries following English law, a mortgage of personal chattels, if in writing, takes the form of a bill of sale, in which case it must be made in accordance with the provisions of the Bills of Sale Acts, 1878 and 1882[11/] and be duly registered. In order that a bill of sale by way of security should have effect against third parties, the chattels to which the bill relates should be capable of specific description and should be specifically described in the schedule annexed to the bill of sale.[12/]

(b) Floating charge

8. Reference may be made here to the so-called floating charge, an institution developed under English law, by which the indebtedness is secured by a charge or lien on all the assets, present and future, of the debtor. The security only attaches to any specific assets when the floating charge has become "crystallized"[13/], i.e. when the debtor-company is liquidated or a receiver appointed. Similar liens are known in other legal systems with the difference, however, that the floating charge constitutes a specific lien.

11/ The Bills of Sale Acts apply only to mortgage of personal chattels excluding ships (Section 4 of the Bills of Sale Act, 1878), but including aircraft. Mortgage of other choses in possession, such as mortgage effectuated by the deposit of stock or share certificates with or without a blank transfer remains subject to the rules of equity.

12/ Cf.: Halsbury, "Laws of England", vol. 3 3rd Ed., p. 275.

13/ Re Griffin Hotel Co., Ltd. [1941] 1 Ch. 129.

(c) Fiduciary transfer of property

9. There are some civil law countries where the legal requirement that the pledge be removed from the pledgor's control has been rigorously upheld and where the legislator has not created exceptions to this traditional rule by permitting, in certain cases, that the pledged goods remain in the debtor's possession. This situation has motivated the recourse by creditors, though not always successfully, to other devices, such as conditional sales,[14] contracts whereby goods are sold but the buyer stipulates the right to repurchase the goods at an agreed price within a specified period, or leasing with an option to buy. In a few countries,[15] case-law has come to accept another security device, known as fiduciary transfer of property, or fiduciary-ownership, which constitutes a civil law counterpart of the common law chattel mortgage by bill of sale. By this contract, which is especially used by financial institutions in loan operations, the debtor transfers title to personal property to the creditor as security for an indebtedness, while retaining possession thereof.[16] This system is unique in that it is not necessary that the contract be made in a particular form or in writing and that no special formalities are required. The security interest of the creditor is his title to the goods, which, owing to the absence in the countries concerned of such rules as possession vaut titre[17] and reputed ownership,[18] affords an effective protection

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14/ See paras. 10 - 15 below.

15/ E.g. Germany, (Sicherungsübereignung), Indonesia, Netherlands.

16/ This device has been developed considerably in German law where a number of standard contracts are in use, such as, in particular: (i) The E-contract (E-Vertrag) which is used where machinery, etc. serves as security. Under this contract, the debtor may not sell the goods involved and must "individualize" them by marking; (ii) The A-contract (A-Vertrag) which permits the debtor to sell (used in the case of merchandise); (iii) The R-contract (R-Vertrag) by which the goods serving as security are indicated by the place (warehouse) where they are located (used for goods which are commonly replaced at more or less regular intervals); and (iv) the M-contract (M-Vertrag), under which the goods are marked and, in the case of sale, must be replaced with notice to the creditor.

17/ As in French law and similar systems.

18/ As in English law and similar systems.

against third parties and the assignee in bankruptcy.[19] Owing to the absence of publicity, fiduciary transfer of ownership has been the subject of criticism and, in both Germany and Netherlands, voices are heard which advocate a system of registration.

(d) Conditional sales

10. When selling on credit terms,[20] the seller may also secure payment of the purchase price by retaining title to the goods sold until full payment has been made. The intended effect of this clause is that the ownership of the goods does not pass upon the conclusion of the contract or through delivery, as the case may be according to the legal system which is applicable, but is made conditional upon the fulfilment of a condition, usually the payment of the purchase price (pactum reservati dominii donec pretium solvatur).[21]

19/ In the Netherlands, the statutory provisions of pledge should, according to the Supreme Court, be applied as far as possible. The debtor, upon performance, recovers ownership.

20/ This report does not deal with the hire-purchase and retail instalment sales legislation which has been enacted in many countries with a view to giving special protection to consumers. As a rule, this type of legislation prohibits the stipulation of what are considered to be unfair clauses and frequently applies only where the hire-purchase price or total purchase price does not exceed specified amount. Some of the more recent laws also empower the government to regulate the flow of credit by means of imposing larger or smaller down payment requirements, fixing the maximum period of credit and number of payments and increasing or lowering the upper limit of the purchase price. Sales within the ambit of these laws are almost invariably domestic sales.

21/ Many legal systems have assimilated other contracts having a similar purpose, such as hire-purchase agreements and bailment-lease agreements, to conditional sale agreements. In most common law countries, however, chattel mortgage and conditional sale have retained their separate identity with the result that different rules obtain, under each of these security transactions, with regard to the rights of the parties.

11. Few countries have enacted special legislation for this type of contract.[22] More often it is dealt with in civil codes or in sale of goods acts[23] or not mentioned at all.[24] Yet, owing to the interference of certain basic principles, some of which are of "ordre public", the effects of the contracts of conditional sale may differ considerably in different jurisdictions.

12. As a rule, the seller's security in the goods sold under a conditional sale contract is based on title. In the Uniform Commercial Code of the United States, however, the conditional sale is characterized as a secured transaction and is, as such governed by the provisions of Article 9.[25] As a result, "the retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer... is limited in effect to a reservation of a "security interest"".[26]

22/ E.g. Canada: Uniform Conditional Sales Act (1922); Denmark (1953), Norway (1916) and Sweden (1915): Instalment Sales Acts (these Acts are based on identical principles and are applicable to the sale of movables when the purchase price is payable in one or more instalments after the goods have been delivered to the buyer and when it is stipulated, inter alia, that the property of the goods remains with the seller until the price, or a part thereof, has been paid. Cf.: Art. 7 of these Acts).

23/ Italy: Articles 1523-1526 of the Civil Code. See also Articles 1576h-1576x of the Civil Code of the Netherlands which are however only applicable to conditional sales when the purchase price is payable in two or more instalments after the delivery of the goods. Some laws give a definition of conditional sale (e.g. Section 19(1) of the English Sale of Goods Act, 1893) and/or provide for the right of the seller, in the event of default of the buyer, to demand immediate payment of the purchase price or to terminate the agreement and recover the goods (e.g. Article 455 of the German Civil Code (BGB)).

24/ E.g. France.

25/ See paras. 16 and 17 below.

26/ UCC, Section I-201 (37).

13. In general, the retention of ownership clause produces the effects which the parties have stipulated, i.e. that the seller may repossess the goods upon default of the buyer without the latter having the right to redeem,[27] and such repossession entails the termination of the contract.[28]

14. The solutions adopted in respect of the relationship between the seller and third parties reflect the existence of two principles, protecting either the right of ownership of the seller under a conditional sale,[29] and denying therefore that third parties can acquire title of ownership from a non-dominus,[30] or giving priority to the necessity of protecting commercial relations which require that, in the normal course of business, a buyer in good faith should get a good title. While it would seem that the second principle has now gained the upper hand, the conditions upon which the protection of third parties depends may vary. Some

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27/ This is therefore a feature which distinguishes the conditional sale from the chattel mortgage. Under a chattel mortgage, the mortgagee cannot foreclose upon default of the mortgagor, except after having given the latter an opportunity to redeem.

28/ Some countries, however, limit the effects of the clause as between seller and buyer when payment is made by instalments. Thus, Article 1526 of the Italian Civil Code provides that, in the case of an instalment sale (vendita a rate), the seller who retakes possession of the goods shall restitute the instalments already paid, subject to receiving damages, while the contract may not be terminated when only one instalment has not been paid if this instalment does not represent more than one eighth of the purchase price. Similar provisions obtain in the Scandinavian legislation on instalment sales.

29/ Following thereby the Roman law principle ubi rem meam invenio ibi vindico.

30/ Nemo plus iuris in alium transferre potest quam ipse habet or the common law rule: nemo dat quod non habet.

laws require for such protection that the goods shall have been delivered to the third party[31] and that the third party shall have taken for value.[32] Other laws, however, do not demand such conditions.[33] The common law countries generally follow the nemo dat quod non habet rule,[34] but with important exceptions.[35] The United States Commercial Code replaces the concept of title by that of a security interest. Consequently, the security interest of the conditional seller, if unperfected,[36] will not be protected against a third party who acquires in good faith for value and, if perfected, will be defeated by a buyer in the ordinary course of business.[37]

15. The differences between legal systems are most patent in respect of the effects of the clause in the event of bankruptcy of the conditional buyer. In some countries, the seller can successfully rely on his title of ownership,[38]

31/ E.g.: Article 367 of the Austrian Civil Code; Articles 929 and 932 of the German Civil Code; Article 714 of the Swiss Civil Code.

32/ E.g.: Austria, ibid; Netherlands, Articles 637 and 2014 of the Civil Code.

33/ As in French law and similar systems. In French law, third parties are protected by virtue of the principle en fait de meubles, la possession vaut titre (Article 2279 of the Civil Code).

34/ E.g. England: Section 21 of the Sale of Goods Act, 1893, Cyprus: Section 27 of the Sale of Goods Law.

35/ See e.g. The English Factors Act, 1889, introducing two exceptions. The first exception relates to the sale, pledge, etc. of goods by a mercantile agent who is in possession of the goods with the consent of the owner, while the second exception concerns a contract of sale by virtue of which one of the parties has the ownership and the other the possession of the goods sold, e.g. in a conditional sale. In both cases the third party who acquires in good faith obtains a good title which is valid against the owner.

36/ See para. 17 below.

37/ See UCC-312 as to priorities between competing perfected security instruments.

38/ E.g. under Austrian, Danish, German, Dutch, Swedish and Swiss law.

while in others such title would not give him any priority over other creditors.[39] In still other countries, the position of the conditional seller vis-a-vis the trustee in bankruptcy and the other creditors of the buyer may depend on a variety of factors.[40]

(c) The Uniform Commercial Code of the United States

16. A noteworthy development of the law of securities is to be found in the Uniform Commercial Code (UCC) of the United States. Instead of different rules for various types of security in personal property (e.g. pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security there is a comprehensive set of rules for what is termed a security interest. All security interests operate essentially the same way, although there are certain variations to accommodate specific needs. Under a secured transaction, the debtor has the right of redemption and the right to surplus on the sale of the collateral upon his default, while the creditor has the right to foreclose without judicial process, the right to deficiency and priority.

17. "Perfection" of a security instrument is usually accomplished by filing with the appropriate authorities or by taking possession of the collateral. If imperfected, the security instrument is effective between the parties to the transaction but is defeated by a perfected security instrument, and unlike a perfected security instrument, by a lien creditor without knowledge, by the debtor's trustee in bankruptcy and by a good faith transferee who gives value.[41] UCC 9-312 sets forth the priorities among competing perfected security interests in the same collateral.[42]

39/ This is the position in countries following the French legal system.

40/ E.g. in the common law countries following the "reputed ownership" rule, which admits however of certain exceptions.

41/ Under UCC-9-307, a buyer in ordinary course of business will defeat even a perfected security interest.

42/ However, artisans, mechanics and others who provide services or material to a chattel which is already impressed with a prior security interest may defeat that interest.