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PROPERIERARY SECURITY: PLEDGE, RETENTION AND TITLE SECURITIES

5.1.3 - Private law (civil law) sciences

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ANNOTATION

The relevance of the topic of research. For many centuries a real credit (that is, a credit secured by the value of the property of the debtor or a third party) has been one of the main ways to provide the participants in private transactions with financing. At the same time, at various historical stages of its development, the forms of real credit changed - from the transfer of complete dominance over the thing that serves as security, to the formation of an idea of the security right in relation to property remaining in the possession of the person who provided the security.

Current trends in the sphere of secured credit are as follows. Firstly, the leading jurisdictions again seek to return to the original legal forms that seemed to have been abandoned forever, suggesting that the creditor is given the right of absolute (or close to the latter) dominance over the subject of security. Secondly, the trend of dematerialization (contrary to its original name!) of the subject of real security is quite clearly manifested: these are not only things (both movable or immovable), but also registered rights of participation in a corporation, rights to intellectual property, as well as receivables.

The three most pressing legal problems that the practice of real credit has posed for theoretical jurisprudence are the problem of accessoriness, the problem of the fairness of the priority of the secured creditor, and the legal development of the so-called title security.

The problem of accessoriness is closely intertwined not only with doctrinal views on the legal connection between a secured debt and a structure of a security device - it is of tremendous practical importance. Strict implementation of the idea of accessoriness makes real security not quite convenient (from the point of view of practice) as a security instrument. Therefore, the understanding of the doctrine of accessoriness and the development of correct law enforcement approaches simultaneously serve to resolve both theoretical issues and practical problems in the field of real security.

The same applies to the problem of the fairness of the priority accorded by a security *in rem*. It is a tangle of conflicting and opposing interests of various creditors. The solution to this puzzle is not only of theoretical but also of practical interest: it translates into the search for a regulation of the procedure for secured creditor claims in bankruptcy of the debtor which would both satisfy the sense of justice and be economically efficient at the same time.

Finally, the most curious trend in the field of proprietary security, which is waiting for its researcher, is the rise, fall and new rise of ways to secure obligations based on the use of a property right (or another similar right, ensuring legally the most complete domination over a certain good). It is striking how the circle of history has closed: having begun with the *fiducia* of Roman law, it - having passed through various forms of pledge law - returned, in fact, to its original position in the sphere of title-based security.

The presence of these tendencies allows us to affirm that, despite the abundant literature on, say, the law of pledge, the study of the legal issues of securing claims by means of the value of certain property belonging to the debtor or a third party is still topical. And it is especially relevant in connection with the development of ideas about securing debts by means of the value of property as a single legal institution. In what follows this text will be referred to as collateral *in rem*, since such collateral deals precisely with the law of rem, that is, with the law describing the legal relationship between a person and a thing.

The term "real security" is in a sense an allusion to the expression real security as used in English-speaking countries, which generally refers to a security established over property (and hence real) other than real property. However, as far as can be seen, not all English-speaking lawyers are inclined to use this term to denote real security. This is due to the fact that the division of rights into real (or rather, property) rights (*rights in rem*) and personal rights (*rights in personam*), which is characteristic of English law, in general does not coincide with the division of rights into rights of obligations and rights in rem held by continental lawyers. For

example, in the authoritative work of the English jurist R. Calnan's the security established over property is referred to simply as security.

The expression real security is often used by jurists of continental jurisdictions, writing in English, it is stressed that this term allows to successfully contrast security of claims by the value of certain things against security established by the assumption by a third party of a guaranteeing obligation, called personal security (a term which is not, incidentally, known to common law lawyers), that is, personal security.

Similar is the German legal terminology using the terms *Personalsicherheit* and *Realsicherheit*, denoting personal and real security, respectively.

Similarly, in French legal language it is customary to distinguish between collateral *in rem* and collateral *in personam*: *les sûretés réelles* and *les sûretés personnelles*. It is curious that, for example, in such an unusual jurisdiction as Louisiana in the United States (which is a so-called mixed jurisdiction - a mixture of French law and common law), the terms real security and personal security are used with the same meaning as in the continent. In Spanish law there is also the same dichotomy: *una garantía personal* is opposed to *una garantía real*. The same situation is observed in Italian legal language (*garanzie reali e garanzie personali*).

In addition, it is the term real security that is used by romanists writing in English when describing, for example, Roman pledge constructions.

A little more precisely, in my opinion, the drafters of the Draft Common Frame of Reference (DCFR) of the European Union Civil Law Codification refer to the security established in respect of things as *proprietary security*. This term obviously tends to underline that the security effect of a relevant legal construction is achieved either by means of establishing special proprietary rights which improve the creditor's position in the event of default (or bankruptcy) of the debtor (security rights), or by means of transferring the right of ownership to the subject of security from the provider of security to the creditor (retention of ownership devices).

In this connection the DCFR developers contrast *proprietary security*, a concept which implies proprietary rights over the property of a security provider established for the purpose of security, with the concept of *personal security*, that is personal security which consists in establishing the obligation of a third party to satisfy the creditor in the event of the debtor's default.

The latter approach - contrasting real and personal collateral not in the context of satisfaction out of/by the obligation of the collateral provider, but in the sense of having a real right with a securing effect (real collateral) or a simple third-party obligation which gives the creditor additional opportunities to collect the debt (personal collateral) - seems to me to be the most accurate.

There is no doubt that even in the case of personal collateral (surety or guarantee), the creditor also obtains satisfaction from the property of the person providing the collateral, not from his person. The latter is not possible due to the fundamental rejection of the Western legal tradition several centuries ago of, for example, the conversion of the obligated person into a slave or the satisfaction of the creditor from the proceeds of the sale of the obligated person into slavery. Enforcement proceedings (or insolvency proceedings) instituted against a surety or guarantor would inevitably assume that the bailiff would merely seize the property of the person who had provided personal security, sell it at auction, and the creditor would receive what was due from the proceeds.

Thus, whether in a proprietary security or a personal security, the creditor will always be satisfied out of the value of the security provider's property.

However, if the distinction between personal and real collateral is evaluated in terms of the approach proposed by the drafters of the DCFR, it becomes more obvious. Proprietary security implies that the creditor has rights *in rem* through which he obtains the desired security effect (discussed below), these rights can be either (a) a proprietary security right or (b) an ownership property right established (transferred, retained) for a security purpose. Consequently, all doctrines of property

law (followership, publicity, priority, defensibility against an unlimited number of third parties, etc.) are subject to full application to such a secured creditor.

A personal security, on the other hand, implies that the creditor has a claim against the person who provided the security. This would mean that the relationship between the creditor and the security provider would be established in accordance with the doctrines of the law of obligations (strictly personal nature of the relationship between creditor and security provider, no priority over third parties, etc.).

Based on this consideration, the term security *in rem* should not be understood in the sense of a *proprietary security* (a surety is also a "*property*" security in the sense described above), but as a totality of those rights in rem, which may provide their holder with a security effect.

As already mentioned, there are two such rights - a pledge and the right of ownership. However, the use of other limited property rights as a security mechanism is also conceivable (for example, the construction, which in the draft reform of the property law of the Russian Civil Code is known as the right of real burdens, close to the German construction referred to as *Die Reallast*, § 1105 BGB). However, in the event of failure to fulfill the obligation to pay the due amount of money, the person in whose favor the real burden is established, would obtain the rights of the mortgagee (clause 1 of Art. 305 of the Civil Code as amended by the draft of the property law reform).

The concept of security *in rem* acquires particular relevance in connection with the development of legal concepts of bankruptcy and the position of the creditor, whose claims are secured by means of security *in rem*, among other creditors of the debtor (or other person who provided security). Should all persons who have been secured *in rem* have the same legal position? Or can there be not only secured creditors, but also "super-secured" creditors?

This paper focuses on all of these relevant issues (the nature of security in rem, its principles, the regulation of security in rem in bankruptcy, etc.).

Topic development. The degree of development of questions of the law of pledge in Russian legal science is very thorough. This includes brilliant oldschool Russian monographs on pledge (D.I. Meyer, A.S. Zvonitsky, L.A. Kasso, L.V. Gantover, etc.) and modern studies on pledge (V.A. Belov, B.M. Gongalo, V.V. Vitryansky, L.A. Novoselova, A.A. Yegorov, N.Y. Vityansky, L.A. Novoselova, A.V. Egorov, N.Y. Rasskazova, E.A. Evdokimova). Considerably less attention is paid to the right of retention (here we can mention, first of all, the work of S.V. Sarbash). Russian-language literature on title security is just beginning to appear (see works by S.V. Sarbash, A.V. Egorov, E.A. Usmanova, S.A. Gromov, P.V. Khlyustov).

However, I do not know any works in Russian, which would try to analyze all the above methods of securing of claims *in rem* as a unified legal institute.

Theoretical basis of research. Theoretical basis of the study consists of scientific works of domestic legal scholars - both old-school Russian (L. V. Gantover, A. S. Zvonitsky, L. A. Kasso, D. I. Meyer) and modern (V. A. Belov, V. V. Vityansky, B.M. Gongalo, D.V. Dozhdev, A.V. Egorov, L.A. Novoselova, S.V. Sarbash, E.A. Sukhanov, K.I. Sklovsky, V.F. Yakovlev and others).

In addition, the work used literature sources in foreign languages (C. von Bar, H. Beale, P. Bülow, R. Calnan, M. Dixon, U. Drobnig, S. van Erp, E.-M. Kieninger, L. LoPuckie, L. van Vliet, Ph. Wood, etc.).

Object and subject of the dissertation research. The object of the thesis research are the legal relations associated with the establishing and termination of proprietary security, as well as associated with the implementation and protection of the rights of a secured creditor. The subject of the study are the norms of the current Russian legislation and other legal systems, as well as the doctrinal views of legal scholars on the problems of proprietary security.

The aim and objectives of the dissertation research. The purpose of the work is the scientific development of the concept of proprietary security as a single complex institute of private law, as well as the study of the basic principles of its functioning.

The objectives of the dissertation research are:

1) study of the place of proprietary security in the system of methods of securing the claims, as well as individual methods of securing obligations that form the concept of proprietary security;

2) analysis of the doctrine of proprietary security accessoriness as applied both to the right of pledge and to the mechanisms of title security;

3) analysis of the priority given to a creditor by a security *in rem*, as well as the fairness of that priority in relation to other creditors of the security provider;

(4) an examination of the problem of the legal relationship between the mechanisms of real security and the legal ability to manage the property transferred as collateral during the existence of the security right;

(5) analysis of the ways to give the effect of publicity to proprietary security, as well as the consequences of the lack of publicity;

6) an examination of legal doctrines describing the nature and content of the right of pledge;

(7) an examination of the problems associated with the legal nature and mechanism of the right of retention;

8) analysis of mechanisms that form the so-called title security (security sale, security retention of title, security assignment, financial lease), in particular the problems of application of these security mechanisms in the bankruptcy of the security provider, as well as in the bankruptcy of the secured creditor.

Methodological basis of research. The methods of dogmatic, legal-political, historical and comparative legal scientific analysis have been used. The subject of

the analysis are doctrinal views of legal scholars, norms of Russian legislation and legislation of other legal systems (including historical), as well as judicial acts on issues of proprietary security.

Scientific novelty of the dissertation research. Scientific novelty of the research lies in the fact that it is the first Russian-language comprehensive study of the institute of proprietary security as an integral legal phenomenon, which has its own unique characteristics, principles and features. The study presents a scientific concept of security *in rem* and details its constituent elements (the property of accessory nature, priority, publicity, etc.).

Thesis for the defense. The following thesis are presented for defense:

1. Proprietary security should be understood as a method of securing claims, which is based on the use of property rights (including the right of ownership), allowing its holder (the creditor) in preference to other creditors to appropriate the value of things in case of non-fulfillment of obligations by debtor. The paper substantiates that the scientific perspective has a view on the legal concept of proprietary security, assuming the unity of the legal institute, covering pledge, retention and title security constructions (security transfer and retention of property right, factoring, leasing).

2. The accessoriness of a proprietary security characterizes the legal connection between the secured claim and proprietary security right and is manifested at all possible stages of the existence of the claim (emergence, modification, assignment, enforcement, termination). The paper proves that accessory nature is a feature not only of pledge, but also of title security constructions. Historical and comparative legal analysis shows a tendency for the principle of accessoriness to weaken. This is manifested in the possibility of creating security rights before the secured debt arises, the possibility of limiting the right of the secured person to raise relief based on the creditor-debtor relationship, the possibility of continuing the existence of security after the secured debt ceases to exist and in some other cases. However, it is hardly

possible to completely abandon the accessory characteristic of proprietary security, as it would contradict the economic purpose of the security.

3. The main purpose of proprietary security is to improve the position of the creditor in case of bankruptcy of the debtor by giving the creditor a priority right of satisfaction out of the value of the collateral. This priority may be limited to a certain portion of the value of the collateralized property, or it may be full, that is, allowing the creditor to appropriate the entire value of the collateral.

4. The paper substantiates that the choice of priority model is based on legal and political considerations, which in turn are based on economic, ethical and moral attitudes. The ethically justified desire of the legislator to provide increased protection for claims for compensation of harm caused to health leads to the fact that the priority of the secured creditor's claim is limited in favor of creditors on tort claims of this kind. The paper analyzes the collision of a secured creditor *in rem* with different groups of unsecured creditors (voluntary and involuntary) and concludes that the priority of secured in rem over the claim of an involuntary creditor whose claim arose after the establishment of secured *in rem* is unfair and should therefore be excluded by the legislature.

5. The establishment of the proprietary security gives rise to the possibility for the secured creditor to exert some intensity on the management of the collateralized property. In this regard, the paper analyzes the dependence of the type of proprietary security and the "management capacity" of the secured creditor. It is shown that if, under a possessory security construction, a creditor has a security right consisting solely or substantially in the right to appropriate the value of the property serving as collateral, while not having the ability to manage the property, he is effectively free from any risk of loss, damage or any other deterioration of the property. As the security right is "diluted" with a "managerial element" reflected either in the transfer of possession of the object of security or in the transfer of ownership (or another right ensuring legal dominance) of the property to the creditor, its liability to the

grantor grows sharply as the "managerial capacity" of the creditor increases. In general, this pattern seems to be justified.

6. The paper proves, that the use of the mechanism of security *in rem* can also be assessed from the angle of protection of the property of the person, who provided the collateral, in the interests of the unsecured creditors. This manifests itself in the fact that the collateral *in rem* blocks the free disposal of the subject of security. Consequently, unsecured creditors will have at their disposal an amount of value equal to the excess of the total value of the collateral over the amount of the secured debt. In addition, if the collateral provider goes bankrupt, a portion of the proceeds from the sale of the collateral will also go to unsecured creditors. This consideration is an additional argument in favor of the priority afforded by proprietary security.

7. The seizure of a debtor's property by a court at the request of a creditor should not be regarded simply as a legal mechanism similar to a pledge, but should be qualified as giving such a creditor a proprietary security right with respect to the debtor's property. The explanation of the priority of a creditor in whose favor a lien is set includes dogmatic, theoretical, and economic considerations. A lien is a situation in which the value of some debtor's property is appropriated (by the court, by a bailiff) to be responsible for a particular debt. This legal connection between the creditor's claim and the property seized for the purpose of satisfying it cannot but give rise to a priority. In addition, the existence of a priority attachment protects the interests of other creditors of the debtor who have not achieved the attachment (through restrictions on the disposal of property, the existence of a possible surplus, the application of collateral quotas). Finally, a priority secured lien disincentivizes a creditor to insist on the debtor's bankruptcy and forced sale of his property.

8. Since a pledge right is regarded as a right to property (or similar rights securing control over intangible assets – paperless securities, participatory interests in limited liability companies) opposable to third parties, the task of the legislator is to ensure the publicity of such rights. This is achieved either by placing the collateral in the possession of the creditor or by marking the burdened property, as well as by

confirming and registering the security rights. This applies not only to pledge, but also to title security constructions. The paper argues that the lack of publicity of collateral should not only affect the position of new owners or pledgees of property serving as collateral, but also unsecured creditors - in the latter case, the creditor holding a security in rem should not have priority.

9. The paper proves that the most adequate theory to explain the nature of pledge is the “value theory”, which recognizes the content of the pledge right to appropriate the value of the pledged property. This right is a right *in rem* because it not only follows the pledged property and its protection is provided by a set of property claims, but also gives its holder the right to determine the “legal fate” of the value of the pledged object in the foreclosure procedures. The view of the right of pledge as a right to appropriate the value of an object makes it possible to fairly resolve numerous mishaps in the field of pledge law. In addition, it dogmatically explains proprietary security’s priority, the phenomenon of property subrogation (otherwise known as the principle of “collateral elasticity”), the nature of transactions with pledgee’s ranks, the bona fide acquisition of a pledge right, and much more. Other approaches to the nature of the lienholder's right (primarily treating it as a contractual right) cannot provide satisfactory solutions. Finally, a view of the right of pledge as the right to appropriate the value of pledged property allows to reconcile the qualification of pledge as a property right with the possibility of establishing a pledge over intangible objects (claims, corporate rights, exclusive rights).

10. The paper analyzes the problems of the legal position of the retentor and, in particular, the problem of priority of the claim secured by the possession of the latter. It is argued that the model of retention adopted in the current Russian civil law (the so-called "executionary retention", which involves the right of the retentor to start foreclose proceedings against the object of retention under pledge rules and opposes "defensible retention", which does not involve the right to sell the object of

retention by the retentor) inevitably leads to the conclusion that the retentor’s claim should be given the same priority as the pledgee claim in bankruptcy of the pledgee.

11. The paper justifies why the retentor's claim should enjoy priority over the claims of other creditors. This is explained both dogmatically (the retentor legitimately possesses the object of collateral, and so his position with respect to the latter cannot but be stronger than that of non-owning creditors) and economically (in the absence of priority, those who provide services to owners related to the improvement of property owned by them are encouraged to demand advance payments from counterparties; hence, the availability of such services will be lower, since not all potential consumers of such services have the ability to advance payments).

12. The paper analyzes the reasons for the emergence of title security structures as an alternative to pledge from both historical and comparative legal perspectives. It is concluded that these reasons may be the archaic requirements for establishing a pledge right (for example, the need to transfer the subject of pledge into the possession of the pledgee), the inconvenience of regulating pledge procedures, bankruptcy laws that do not satisfy creditors, as well as the specifics of tax law regulation. For modern Russian law, the main reasons for the emergence and spread of title security are the last three (the peculiarities of tax regulation have had a particularly noticeable effect on the growing popularity of leasing). The paper proves that it is a mistake to deny the existence of title security solely because of the presence of pledge in the current Russian legislation. The diversity of legal forms, allowing to achieve the same economic goals, is a feature and advantage of developed private law, offering creditors the set of different legal tools to solve economic problems. At the same time, the legislator's task is to avoid circumventing the imperative rules of pledge law by means of title security constructions. These peremptory rules include, first of all, provisions on *superfluum*, protection of interests of private persons when using their sole house as security for their

obligations and provisions of correlation ratio of claims of secured creditor and unsecured creditors in case of bankruptcy of the person who provided the security.

13. The paper analyzes the peculiarities of application of the doctrine of accessoriness of proprietary security to the specific type of title security and makes a conclusion that all elements of the classical doctrine of accessoriness of secured transactions can also be found in title security. This is particularly relevant in the context of so-called "accessoriness of volume", i.e. the restriction of the volume of a security right by the amount of the secured debt: in some cases this is achieved by legal provisions (factoring) and in some cases by judicial practice (buy-out leasing). In other cases, as argued in this paper, it is possible to achieve the effect of accessoriness by applying the rules on unjust enrichment to the relations between the secured creditor and the provider of the collateral. Another important manifestation of accessoriness - accessoriness of termination - will manifest itself in title security constructions when applying the norm of Clause 4 of Article 329 of the Civil Code which sets a general rule about the termination of any security upon termination of a secured debt.

14. The paper proves that title security in bankruptcy of the security provider should, as a general rule, be treated in the same way as a pledge. However, if legal and political considerations would require that advantage be given to certain groups of creditors who negotiate title security in their favor, the legislature may give the relevant creditors super-priority with respect to the scope of the obligation, allowing the full appropriation of the value of the property transferred as title security. For example, in order to protect the proprietary interests of manufacturers of expensive equipment (and thereby encourage them to grant deferrals and installments on payments to buyers), the legislator may establish that such title security, as a reservation of title with a security purpose, will entitle the creditor to withdraw the object of security from the buyer's bankruptcy estate without paying a portion of the value of the item into the buyer's bankruptcy estate. However, the starting point, as

the paper proves, should be the equal position of all creditors having the proprietary security.

Theoretical and practical significance of the research. The theoretical significance of the research lies in the formulation of a coherent and consistent doctrine of proprietary security, the basic tenets of which can serve as a methodological basis for the resolution of individual doctrinal issues of the law of pledge, lien and title security.

The practical significance of the study consists in the possibility of using its results in resolving disputes, in the analysis of practical situations related to the proprietary security, in lawmaking.

Degree of reliability and approbation of the results of dissertation research. All conclusions contained in the research were formulated and published in monographs 2008-2021 and journal publications in leading legal journals (2003-2021), discussed at scientific conferences. The results of research in the sphere of property collateral were used in the course of work on the analysis of judicial practice in the sphere of commercial disputes related to collateral (resolutions of the Supreme Commercial Court of the Russian Federation in pledge law and by-out leasing), as well as in work on the reform of Russian pledge law (Federal law from 21.12.2013 № 367-FZ).

Structure of the work. Proceeding from the fact that the security effect can be achieved through the use of two types of rights (pledge and the right of ownership or a similar right securing the dominion over the property), the thesis is split into three parts.

First of all, the paper analyzes the issues of both the general concept of collateral and of proprietary collateral in particular, to which the problems of (a) accessory nature of collateral, (b) collateral priority, (c) the effect of management of the subject of collateral arising in the establishment of proprietary collateral, (d) publicity of collateral are attributed.

Then the issues of the law of pledge (as well as a doctrine of retention), with a special emphasis on the problem of pledge as a right *in rem* are examined. And then I study the issues of the so-called title security, i.e. cases of using the right of ownership to achieve the security effect. It would appear that today's modern Russian law provides ample empirical material to analyze not only pledge (as a well-known legal construction) but also title security. Here I may mention (a) retention of title and (b) security assignment known to our Civil Code; actively developing (c) byu-out leasing, and (d) security sale and purchase, which is increasingly common in practice. It seems that in spite of seeming external differences all the mentioned constructions (designated by developers of DCFR as retention of ownership devices) have quite a lot in common, first of all they dramatically improve position of a creditor who has negotiated such "device" in his favor, especially in case of bankruptcy of the provider of security. This chapter will be devoted to an attempt to find this common ground.

In the conclusion the conclusions drawn in the course of the study of the institute of real collateral are formulated.