Purchase Money Security Interests in Common Law and the French System of Civil Law

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It is a mistake to consider the common law and civil law as opposite systems of law. It is much more accurate to consider them as closely related species within the same genus, namely western law. This is true historically. England was part of the Roman Empire; in the Middle Ages it was part of Christendom. It participated in the Renaissance, the Reformation, the rise of the national state, the rise of capitalism and the colonization of the New World. These were experiences shared by most of the European nations. In terms of culture, economy and tradition, France and England may have a good deal more in common than France and Switzerland or Germany and Italy.

This consanguinity means that the problems faced by the law are likely to be the same, and that the desirable solutions are also likely to be similar. The differences between the common law and the civil law, then, tend to be in techniques and rationalizations more than in results. This is often missed if statutes are compared, rather than the working of the system. If there is no institution A which seems essential, there is often an institution B that takes its place.

This is true in the area of purchase money security interests. Both the French civil law and the common law recognize some special claim that a seller should have for the price of goods sold but not paid for. The difference in technique, however, is significant and crystallized by such a long history that it can be confused with a difference in policy. This technical difference is one of the problems in making Article 9 of the *Uniform Commercial Code* useful in a civil law jurisdiction.

The technical difference arises from the suppression of the chattel mortgage in French law and the resulting rise in importance of non-contractual devices. I have limited the title of this paper to a comparison of the common law and the French family of civil law

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because both Roman law and modern German law have a somewhat different technical development.

A certain amount of history might help bring out the problem. A security right in either movable or immovable property could be obtained in the older Roman law by a contract known as *fiducia*. The essence of the contract was that the debtor transferred ownership of his property to a creditor who ordinarily took possession of it and agreed to re-transfer it to the debtor when the debt was paid. While he held it, insofar as third parties were concerned, the creditor was the owner. *Fiducia* was gradually replaced by *pignus*, which corresponded more closely to the modern concept of pledge in that the creditor was not recognized as owner and could not convey valid title to a third party. *Pignus cum fiducia* let the collateral be returned to the debtor in trust. As *pignus* was developing so was *hypotheca*, which openly allowed the creditor to have a security interest in goods not in his possession without the fiction of a pledge and a return of the goods.[1] There is a good deal of confusion as to the exact development of the three institutions and the differences between them.[2] Justinian's *Digest* itself said that the only difference between *pignus* and *hypotheca* was the sound of the name.[3] However, it is clear that although Roman law developed no effective recordation system, both movables and immovables could be used as contractual security without dispossessing the debtor.

As this Roman system amalgamated with the Germanic system in existence in France in the Middle Ages and earlier, the idea of security interests in movable property was modified. In the first place, with the rise of feudal society the distinction between movables and immovables became much more important because immovables had a political as well as an economic significance. Additionally, the Germanic view was that as to movable property, except in the case of lost or stolen goods, a transfer of possession should transfer ownership. The Roman idea of unrecorded yet enforceable rights that could be exercised against innocent third parties seemed much too sophisticated. Thus, in most of France, Roman possession-less pledge or mortgage of movables was not allowed. In parts of France,

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[1] Note that even the Romans took advantage of foreign phrases for legal results that were not to be analysed. *Hypotheca* was a Greek legal term.

[2] See generally, Sohm, R., *The Institutes*, 3rd ed., Ledlie transl., (London, 1907), pp. 351-357; Buckland, W. W., *A Text-Book of Roman Law from Augustus to Justinian*, 3rd ed., (London, 1963), pp. 473-481; Wigmore, J. H., *The Pledge-Idea: A Study in Comparative Legal Ideas*, (1897-98), 11 Harv. L. Rev. 18.

[3] *"Inter pignus autem et hypothecam tantum nominis sonus differt"*, *Digest* 20.1.5.1.

however, especially in the south where the Roman influence had been particularly great, the mortgage of movable property was maintained. However, as time went on, an accommodation was made by holding that mortgages on movables are valid but only so long as the debtor (not the creditor) still has possession of the goods. The maxim, which became famous in French law, was "meubles n'ont pas de suite par hypothèque".[4]

The recordation of mortgages on immovable property was slow to develop in France. Henry IV of England established a system of recordation for Paris in 1424, but that went out with the English.[5] Colbert tried it again in 1673, but the nobility was generally opposed to the whole idea on the ground that it was a derrogation of their honour to have their debts publicly exposed. The system was discontinued within two years.[6] Thus, the French Civil Code in 1804, in providing for the recordation of mortgages on immovable property, was experimenting with a new system. Possible systems of security were discussed with a good deal of clarity by the redactors of the Code.[7] The solution adopted in 1804 was basically the following. Conventional mortgages on immovables had to be specific and had to be recorded. As to movable property the idea of recordation seemed impossible because neither the property nor the domicile of the debtor would necessarily remain fixed. Conventional mortgages were therefore not allowed. The only conventional security device was pledge, and it was made quite clear that the creditor must be put in possession of the property and remain in possession — no *hypotheca,* no *pignus cum fiducia,* no secret mortgage.[8]

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[4] Planiol et Ripert, *Traité pratique de Droit civil français,* t. 12, No. 253; Baudry-Lacantinerie et de Loynes, *Traité théorique et pratique de Droit civil,* t. 22, p. xx.

[5] Planiol, *op. cit.,* t. 12, No. 694, n. 3.

[6] Baudry-Lacantinerie, *op. cit.,* t. 23, No. 1431.

[7] Fenet, P.A., *Recueil complet de travaux préparatoires du Code civil,* t. 15, (Paris, 1827), pp. 223-524.

[8] Arts. 2076 C.N.; 2114-2120 C.N.; 2129-2130 C.N. (corresponding Quebec articles: 1970 C.C.; 2016-2020, 2022 C.C.; 2042 C.C. & 2087 C.C., no corresponding article for 2130 C.N.). Legal and judicial mortgages on immovable property were allowed to be general, that is, to apply to all the debtor's property, present and future, and certain legal mortgages did not have to be recorded. Nor was recordation originally required for privileges affecting immovable property. The system for recordation of mortgages on immovable property was reformed in 1855, *Loi sur la transcription en matière hypothécaire,* Law of March 23, 1885, D.P. 1885.4.27, and again in 1955, *Décret portant réforme de la publicité foncière,* Decree of Jan. 4, 1955, D. 1955.44 (see also *erratum* on p. 73), *Gaz. Pal.* 1955.1.503. See Planiol, *op. cit.,* t. 12, No. 695.

At this point it might appear that not only had French law deserted the free-wheeling secret security devices of the Roman law, but that in fact it had approximated the English law of the same period:

> Until early in the nineteenth century the only security devices which were known in our [Anglo-American] legal system were the mortgage of real property and the pledge of chattels. Security interests in personal property which remained in the borrower's possession during the loan period were unknown. A transfer of an interest in personal property without delivery of possession was looked on as being in essence a fraudulent conveyance, invalid against creditors and purchasers.[9]

The difference was in the area of non-conventional security devices. At common law, liens on personal property were tacit pledges, giving the creditor the right to detain the property until paid, but further limiting his right to the period of detention. The civil law also had such tacit pledges and often for the same debts, *e.g.*, the right of a repairman over the goods that he had repaired, and the right of an innkeeper over the baggage of his guest. But the writers of the French Civil Code, while opposed to freely created contractual non-possessory security interests, were not opposed to certain secret interests created by operation of the law for the security of commercially important debts. The most important of these were the lessor's privilege on the goods of his tenant, and the vendor's privilege on the item sold.[10] Together they meant that movables, even inventory, could be used to secure the two most important commercial debts of the age, rent and the purchase of new equipment and inventory.

The lessor's privilege began as a custom of Roman landlords to demand a mortgage on the goods in the premises as security for the rent. It then became an implied condition of all leases of land or buildings.[11] The privilege survived the French Civil Code's cleaning up of things, perhaps because it affects only goods still owned by the debtor on the creditor's premises, and thus does not transgress the negotiability of movables. The lessor's privilege has also become the law of a number of American states, and as such, is honoured by a specific exclusion in § 9-104(b) of the *Uniform Commercial Code.*

The vendor's privilege grew out of the transition from the Roman law of sale that protected sellers by a reservation of ownership until

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[9] Gilmore, G., *Security Interests in Personal Property*, vol. 1, (Boston, 1965), Sec. 2.1, p. 24.

[10] Art. 2102 C.N. (corresponding Quebec articles: 1619 C.C., 1620 C.C., 1223 C.C., 1679 C.C., 1816a C.C., 1996 C.C., 2000 C.C., 2001 C.C., 2005 C.C.).

[11] Buckland, *op. cit.*, p. 480; Planiol, *op. cit.*, t. 12, Nos. 142 ff.

the price was paid, to the French law that declared a sale complete as soon as there was agreement as to the thing and price.[12]

In the French system of civil law, a vendor, by operation of the law, has a privilege for the purchase price of goods sold, so long as the goods remain in the possession of the vendee. This vendor's privilege exists regardless of deception or insolvency, whether there was an intention to give credit or not, without any writing or recordation and without any necessity on the part of the debtor to agree to the privilege.[13] It often enjoys a high rank of priority.[14] The effect of the vendor's privilege, as should be apparent, is very much like an unrecorded purchase money security interest in consumer goods, or farm equipment under $2,500 value under the *Uniform Commercial Code*, but by operation of the law rather than written agreement, and not limited to any particular category of goods.[15]

In addition to the vendor's privilege, which gives the creditor the right to have the goods seized and sold to satisfy his claim for their price, the civil law provides an implied resolutory condition that allows the sale to be set aside and the goods to be reclaimed if the price is not paid.[16] Both the vendor's privilege and the resolutory condition exist in every sale and are lost only if the purchaser no longer has possession of the goods.[17]

The vendor's privilege and resolutory condition are to be admired as an early attempt to use movables as security effectively without returning to unlimited secret agreements. They are also to be admired as devices minimizing paper work and technicalities. "No boiler plate" was available or needed.[18] However, the system of privileges has two major inconveniences. One is that, practically

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[12] Planiol, *op. cit.*, t. 12, No. 188; German law stayed with the Roman system.

[13] Art. 2102(4) C.N. (corresponding Quebec article: 2000 C.C.).

[14] "Privilege is a right that the quality of a debt gives to a creditor to be preferred to other creditors, even mortgage creditors". Art. 2095 C.N. (my translation) (corresponding Quebec article: 1983 C.C.).

[15] See *Uniform Commercial Code*, §9-302(c),(d); §9-307.

[16] Art. 1654 C.N. (corresponding Quebec article: 1536 C.C., however, the resiliation of the sale may only take place in the case of moveables).

[17] Art. 2279 C.N. (corresponding Quebec article: 2268 C.C.).

[18] A comment should be made on the importance of a procedural difference between common law and civil law-namely, the rejection in civil law of agreements for the private repossession of goods as against public order and good morals. This requires expedient means of judicial seizure, but it also eliminates the advantage to be obtained from some of the "boiler plate" in a security agreement. The advantage in a contractual security device is thus further reduced. In Louisiana, but for the effect of the Federal *Bankruptcy Act*, many merchants

speaking, goods can only be used as collateral to finance either rent or their own purchase price. Thus, a merchant wishing to use his inventory or other goods to raise money to pay taxes or some other debt, is left only with pledge, a most inconvenient security device. The second inconvenience is, of course, that the goods cannot be followed into the hands of third parties. This is particularly disadvantageous in financing, *inter alia*, heavy machinery and automobiles which maintain their value even after a number of sales.

The result of these inconveniences has been that in France itself, from time to time, the legislature has provided for mortgages on particular kinds of movables. Some of these are: the mortgage of ocean-going vessels, crops, business establishments as a whole (excluding inventory), and motor vehicles.[19]

Quebec, it appears, has resisted the mortgage of movable property with more fierceness and purity than France itself, but as a matter of fact, national laws regulating banks and several special statutes provide general and special mortgages.[19a] Louisiana succumbed sometime ago with a mortgage of crops in 1874,[20] and a chattel mortgage statute that began as a very limited statute in 1912, and has been amended almost every two years since that date to finally create a very broad chattel mortgage statute.[21]

Professor Gilmore has stated as to Anglo-American law:

> (I)n the field of law with which we are concerned, the most notable contribution of the nineteenth century was the gradual abandonment of the rule which had forbidden nonpossessory interests in personal property. The process can be traced in sales law as the "conclusive presumption" that a seller's retention of possession of goods sold was fraudulent faded into a rebuttable presumption — although it never became entirely clear exactly what the facts were which served to rebut the presumption. In security law the process led to the discovery, invention or creation of a series of what came to be called "independent security devices"... the chattel mortgage was the earliest in time.[22]

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could rely almost exclusively on the vendor's privilege because goods are rarely traced into the hands of 3rd parties and mortgage affords no other advantage in collection and adds overhead expenses.

[19] *Loi qui rend les navires susceptibles d'hypothèques*, Law of Dec. 10, 1874, D.P. 1875.4.64; *Loi sur les warrants agricoles*, Law of July 18, 1898, D.P. 1898.4.91; *Loi relative à la vente et au nantissement des fonds de commeree*, Law of March 17, 1909, D.P. 1909.4.91, S. 1909.3.852; *Loi faoilitant l'acquisition de véhicules ou tracteurs automobiles*, Law of Dec. 29, 1934, D.P. 1936.4.89.

[19a] See especially the rules on Agricultural and Commercial Pledge, Articles 1979a to 1979k C.C. and also the *Bank Act*, 14-15-16 Eliz. II, S.C. 1966-67, c. 87, ss. 88(2), (3), (5) and 89.

[20] Now La.R.S., (1950), 9:4341-43.

[21] Now La.R.S., (1950), 9:5351-65.

[22] Gilmore, *op. cit.*, vol. 1, pp. 24-25.

The point to be made is that this search for effective non-possessory security interest in personal property at common law, typically, took place through the ingenuity of lawyers as draftsmen and of judges as surreptitious broadners of the law. The law grew through contract and decision more than legislation, though all were important. By this time the civil law had already lessened the pressure for the use of movable assets as security through legislation by recognizing the lessor's and vendor's privilege. New crises were met, at least in French civil law, through new legislation. Now we have the common law, or perhaps more properly the law of the United States, abandoning its former technique and turning to codification, but to a codification based on a history of contractual creation of security interests.

For civil law jurisdictions that have already adopted chattel mortgage statutes, the cultural shock of adopting Article 9 is less. Even in these jurisdictions, however, the reduced role of the lien or privilege in the *Uniform Commercial Code*, and the concentration on contractual devices makes Article 9 difficult and sometimes makes it seem a bit backwards.

Article 9 takes quite good care of the seller when he contractually creates a security interest through a security agreement and filed financing statement.[23] As to consumer goods and some farm products, the seller receives special protection, even without filing a financing statement, though with odd limits as to availability against third parties.[24] The seller's protection is a good deal less when he has not contractually provided for a security interest. However, if we are to use a civil law analysis and recognize security interests created by contract (mortgage, pledge) and security interests created by operation of the law (privilege), then it is quite clear that the creditor does receive some security interest by operation of the law under the *Uniform Commercial Code*. It is anathema to say this to an American lawyer working in this field because the effect of labeling a right given to the seller as a security interest by operation of the law, risks that it will be held invalid under the *Bankruptcy Act*.[25] The failure to recognize both contractual and non-contractual rights as security interests is, in my opinion, a failure of legal analysis in both the *Uniform Commercial Code* and the *Bankruptcy Act*. In the case of a sale, complete except for payment

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[23] *Uniform Commercial Code*, § 9-312(3), (4).

[24] See *supra*, n. 15.

[25] See *Bankruptcy Act*, s. 67 c. (1)(B), 11 U.S.C. § 107, (as amended July 5, 1966, Pub. L. 89-495, 80 Stat. 269).

of the price, if it is recognized that the seller, despite the possession of the goods in the buyer, has an interest in the goods superior to that of the buyer's ordinary creditors, from any functional viewpoint this is security interest in the goods. The debt secured is the purchase price. The collateral is the goods sold. To describe the security interest as one by operation of the law rather than by contract is to describe how the security interest came into existence, but not the function of the right once it is in existence.

Under the *Uniform Commercial Code* the rights of a seller, who has not been paid and who has not obtained a contractual security agreement, can be divided into rights before completion of delivery and rights after completion of delivery.

1. If the seller discovers the buyer to be insolvent, he may refuse delivery except for cash.[26]

2. If the seller has delivered the goods to a carrier and discovered the buyer to be insolvent, or if the buyer has not paid on time, the seller can stop delivery in transit under many circumstances.[27]

These two rights functionally could be considered security interests by operation of the law. In both cases the buyer has acquired an interest in the goods, but the seller, for the protection of the purchase price, is also given rights in the goods without any special contract. In the first case the seller is given a tacit pledge, in the second, a limited tacit mortgage. In American law the classification of the right to refuse delivery may be unimportant because the continued possession of the seller protects him from at least the more obvious attacks in bankruptcy. But the right to stoppage in transit, since it is a non-possessory interest and not valid against a bona-fide purchaser, could run afoul of the strictures of the *Bankruptcy Act*.[28]

After the buyer has received the goods, the seller may reclaim them within ten days of receipt, if they were sold on credit and delivered to the buyer while he was insolvent. If there was a written misrepresentation of solvency made to the seller within three months before delivery, the ten day limitation does not apply.[29]

The right of reclamation is greatly weakened by §2-702(3) of the *Uniform Commercial Code* in its original form which provides

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[26] *Uniform Commercial Code*, §2-702(1).
[27] *Ibid.*, §2-705.
[28] See *supra*, n. 25.
[29] *Uniform Commercial Code*, §2-702(1), (2).

that: "The seller's right to reclaim... is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this article." Because lien creditor had been interpreted to include the trustee in bankruptcy as representative of ordinary creditors,[30] the Permanent Editorial Board has recommended the deletion of "lien creditor" so that there can be no doubt that the seller prevails not only over a trustee in bankruptcy representing ordinary creditors, but over other lien creditors.[31] Thus the seller does, in some instances, have a kind of vendor's privilege, or, perhaps more accurately, a resolutory condition, but one a good deal more limited than in the civil law.

It seems obvious that a civil law jurisdiction that wishes to conform to the *Uniform Commercial Code* as to secured transactions would be required to reduce its vendor's privilege and resolutory condition to the much more limited and perhaps confusing right of reclamation. To do otherwise would not only modify Article 2, but would play havoc with the ranking provisions of Article 9. However, lawyers and merchants in a civil law jurisdiction who have become used to the idea of an effective automatically secured vendor's interest in goods sold show some reluctance in switching to the idea that a security interest to be of any importance must be contractually created. An argument could be made that the civil law approach, despite its antiquity, is the more modern one because it does not require repetitious contracts of adhesion under the fiction of individual agreements.

On the other hand, the conflict between the vendor's privilege and resolutory condition on one hand, and contractually created security interests on the other is a conflict that arises even within the confines of a particular civil law jurisdiction once some sort of chattel mortgage is allowed. For example, when the jurisdiction creates a chattel mortgage on inventory, a choice has to be made. If the vendor's privilege, without any notice to the mortgagee, is to prevail over the mortgage on inventory, then the value of the mortgage is considerably reduced. If, on the other hand, the mortgage is to prevail, the vendor's privilege has lost a good deal of its effectiveness. One is forced into the kind of compromise created by §9-312(3) of the *Uniform Commercial Code*, in which the holder of a purchase money security interest in goods going into mortgaged

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[30] *In Re Kravitz*, 278 F. 2d 820 (3rd Cir. 1960).

[31] See 1966 *Report of Permanent Editorial Board.* There has been some hesitancy on the part of the Board to admit that the inclusion of "lien creditor" may have been an error in drafting.

inventory must notify the mortgage holder of his security interest, or be subordinated. The problem is not the intrusion of common law into civil law, but a change in the civil law system. What should perhaps be recognized in the civil law is the duplication of function of privileges and mortgages. As one is increased, the other can be decreased. The French Civil Code relied too heavily on privilege, to the exclusion of needed contractual devices. The *Uniform Commercial Code,* from a civil law viewpoint, may rely too much on contractual devices.