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PRELIMINARY STUDY OF GUARANTEES AND SECURITIES AS RELATED TO INTERNATIONAL PAYMENTS

Report of the Secretary-General

CONTENTS

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(20 p.)

I. INTRODUCTION

1. At its first session, held in New York from 29 January to 26 February 1968, the United Nations Commission on International Trade Law decided to include in its work programme, as a priority t pic, the law of international payments. The Commission selected, as one of the items falling within the scope of international payments, the harmonization and unification of law with respect to guarantees and securities,[1] and requested the Secretary-General "to make a preliminary examination of this matter with a view to the possibility of making a study for submission to the Commission at the appropriate time".[2]

2. In the course of the debate on this item, the United Kingdom representative, who had proposed the item, made the following comments:

> "The problem of guarantees and securities arose in the case of long-term credits, when financing was required for major projects and the method of bills of exchange and documentary credits could not be used to guarantee payment. The creditor would then insist on a guarantee from a third party or a real security. That was an important problem, since development was based on credit, which in turn depended on the guarantees offered. The Commission, while taking note of the provisions of the Brussels Convention on Maritime Liens and Mortgages (1926) and the Geneva Convention on Rights in Aircraft (1948), should study the problem of guarantees and securities in the context of trade relations." [3]

3. In seeking to comply with the Commission's request, the Secretariat considered it desirable to examine the role and use of guarantees and securities in international transactions. In order to obtain information on commercial and financial practice in this respect, consultations were held with officials of the International Bank for Reconstruction and Development (IBRD) and, through the courtesy of the National Association of Credit Management, with commercial bankers and credit managers of large export corporations.[4]

1/ Report of the United Nations Commission on International Trade Law on the work of its first session, Official Records of the General Assembly, Twenty-third Session, Supplement No. 16 (A/7216), p. 22, para. 29.

2/ Ibid.

3/ A/CN.9/SR.1-25, p. 75.

4/ The information so obtained is referred to hereinafter as "Interviews".

The Secretariat acknowledges gratefully the co-operation received from these sources.

4. For the purpose of the present report, the term "guarantees" is understood to refer to contracts whereby a person (promisor or guarantor) undertakes towards another person to discharge the liability of a third person as surety or as primary obligor. The term "securities" is understood to refer to rights or special interests in movable or immovable property stipulated, or statutorily imposed, by way of security for the payment of an indebtedness. Both guarantees and securities are thus directed to affording protection to the creditor in the event of default of the debtor. However, owing to their different legal nature and the problems involved, it appears convenient to consider them separately and in turn.

II. GUARANTEES AND SECURITIES IN INTERNATIONAL COMMERCIAL TRANSACTIONS

A. GUARANTEES

1. Nature of guarantees

5. Depending on their nature and terms, contracts of guarantee are sometimes classified into suretyships, under which the guarantor's liability to the creditor is secondary in that he is answerable for the default of a principal debtor who is primarily liable to the same creditor and contracts of indemnity, under which the guarantor's liability is primary and independent in that he undertakes to indemnify another person for loss caused to the latter by himself or a third person. This distinction pertains primarily to the extent of the guarantor's liability and the defences which he can successfully oppose to the creditor who seeks enforcement of the guarantee.

6. Although substantial differences obtain in national laws, in respect of the same type of guarantee,[5/] the fact that the parties are in principle at liberty to tailor the contract according to their particular needs tends to make these differences less important.

5/ For example, under English law the creditor need not give notice to the surety of the principle debtor's default, or sue the latter, even if solvent, or realize first such securities as the principle debtor may have given him for the same debt before proceeding against the surety. The laws of most civil law countries differ from English law in respect of these matters.

7. It is thus common practice, in the case of suretyships with a foreign element, that the guarantor waives presentment, protests or action by the creditor against the principal debtor as a prerequisite to his own liability, as well as any right to request the creditor to sue the debtor on the principal debt or otherwise enforce payment thereof. It is sometimes also stipulated that, should there exist other guarantees for the same indebtedness in favour of the creditor, the latter shall be free to use them in whatever order or priority he sees fit and may assert his claim against the guarantor without having to exercise his rights under any other guarantee.6/ Provision is also made, as a rule, for the competent court and for the law applicable to the rights and duties deriving from the guarantee.7/

8. It is not unusual, in sustained seller-buyer relations, that the guarantee covers more than one credit or transaction. By such a continuing guarantee, the guarantor, in the event of default of the debtor guarantees payment of the latter's liabilities existing at the time of the conclusion of the guarantee, as well as payment at maturity of whatever amount shall at any time be owing by the buyer to the seller on account of goods sold.8/ It is sometimes further provided in these contracts that the buyer's obligation to the seller mature immediately upon his becoming insolvent on the filing by or against him of any bankruptcy proceeding or the appointment of a receiver.

9. Contractual determination of the nature of the guarantor's liability is also found in guarantee agreements under which Governments guarantee international

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6/ Interviews. Waivers of this kind are also found frequently in agreements providing for joint and several guarantees. See: G.H. Delaume, Legal Aspects of International Lending and Economic Development Financing (1967), pp. 223 et seq, and the examples quoted therein.

7/ E.g. the following provision:

"All rights and duties deriving from this guaranty shall be governed by the laws..., and the Courts... shall have jurisdiction, without prejudice to a possible appeal to.... However, (the creditor) reserves the right to institute proceedings against guarantor in any other... or foreign court, the jurisdiction of which is legally recognized."

8/ E.g. the standard contract of a large corporation specifies that it is irrelevant that the buyer's liability is in the form of an open account, note, trade acceptance, draft, or other evidence of debt.

loans made to corporations or enterprises for specific projects. Thus, guarantee agreements concluded between Governments and the International Bank for Reconstruction and Development usually contain a clause to the effect that "the Guarantor hereby unconditionally guarantees as primary obligor and not as surety merely, the due and punctual payment of the principal of, and the interest and other charges on, the loan, etc....".[9/]

10. In view of this widespread practice to tailor the effects of the guarantor's liability to fit the requirements of particular transactions, it would not seem necessary for the purposes of this report to deal with the relevant rules of national laws. It should be noted, however, that there remain matters, such as formalities, substantive validity and capacity, which remain outside the ambit of the autonomy of the parties and that uncertainties may therefore arise where the contract does not specify the applicable law.[10/] To some degree, therefore, the absence of a widely accepted conflict rule may be considered as an obstacle to international transactions.

2. Bank guarantees

11. Of special importance to international commercial transactions are the various types of bank guarantee which, as such, have not been regulated by national legislation[11/] and are largely the product of business practice.

9/ See e.g. article II of the Guarantee Agreement (Manganese Project) between the Republic of Congo and International Bank for Reconstruction and Development, United Nations, Treaty Series, vol. 452, p. 123.

10/ The law governing the contract of guarantee is not necessarily that of the principal debt. The tendency seems to be towards the rule that suretyship is governed by its own law; see Rabel, The Conflict of Laws, vol. III, 2nd ed., pp. 355 et seq. and the authorities quoted therein. This still leaves open the question as to which is the proper law: lex loci contractus, lex loci solutionis or law of the domicile of the surety.

11/ See however sections 665 to 675 of the International Trade Code (Act No. 101 of 4 December 1963) of Czechoslovakia. Section 665 provides that "under a banking guaranty, a bank (banking institution) undertakes to give satisfaction to the receiver of the guaranty (the entitled person) in accordance with the provisions of the guaranty, if a third party fails to execute his obligation or if the conditions specified in the guaranty are fulfilled." This definition covers guarantee therefore both as suretyship and as contract of indemnity.

12. Such guarantees often resemble a contract, or promise, of indemnity under which the guarantor meets his own commitments, as in the case of an indemnity protecting a party against arbitrary withdrawal from a tender, or a carrier from the effects of claims asserted by third parties if he delivers the consignment in spite of the bill of lading having been lost.[12/] These contracts differ from suretyships in that the guarantor undertakes an independent obligation and that his defences and remedies are consequently of a different nature.[13/] It has been said that the characteristic feature of the bank guarantee "consists not in assuming the debtor's obligation, but in taking over the creditor's risk",[14/] and that its essence "is the interest of the beneficiary in the performance stimulated in the underlying transaction and this interest is expressed in a fixed amount in the contract of guaranty".[15/]

12/ The second example is taken from the comment on section 686 of the Czechoslovak International Trade Code dealing with a promise of indemnity. According to that article, "under a promise of indemnity (declaration of indemnity), the person who makes such promise (the promisor) undertakes to pay indemnity to the promisee if in the course of his activities which he performs upon the request of such promisor, although not bound to do so, he suffers damage."

13/ A frequently used clause in bank guarantees is: "payment on first demand, and notwithstanding any contestation by the supplier or by ourselves or by any other party... " ("à votre première réquisition, nonobstant toute contestation de la part de... "). See E. von Caemmerer, Bankgarantien im Aussenhandel, in Festschrift für Otto Riese, (1964), p. 296.

14/ I. Meznerics, Banking Business in Socialist Economy with Special Regard to East-West Trade (1966), p. 150, where the example is cited of contracts of guarantee "made by banks in capitalist countries by which the banks take over... the risk from the seller residing in a capitalist country (and being usually also the drawer of the bill) for the event that the bill might possibly not be redeemed by parties domiciled in socialist countries.... Guaranty in this case covers the obligation of a socialist bank accepting the bill, independently of the underlying transaction."

15/ Ibid., p. 131.

3. Use of letter of credit as bank guarantee

13. In recent years, there has emerged a tendency to use the commercial letter of credit, in addition to its use as a means to provide payment for international sales, as a bank guarantee or indemnity in the sense that it is conceived as a security against a failure of performance.16/

14. It is, however, not clear to what extent such instruments can be deemed to be guarantees in the legal sense of the term.17/ The question would seem to be important since, in some countries, finance institutions18/ have no power to assume risks such as those implied in suretyship, and would therefore act ultra vires, unless they are organized to engage in the business of undertaking suretyship risks.19/ From another point of view, to the extent that these instruments have

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16/ On this recent development, see Comment, Recent Extensions in the Use of Commercial Letters of Credit, Yale Law Journal (1957), p. 902 et seq., citing, inter alia, a case in which a Government demanded, as a condition of awarding a contract for the construction of a harbour, a letter of credit the amount of which was based upon the damages which it might incur as a result of unsatisfactory performance. The Government was entitled to collect under the letter of credit upon the contractor's failure to perform satisfactorily and its certification to the bank that a breach had occurred (see p. 909). Letters of credit are also used to protect a buyer against faulty performance in connexion with shipbuilding contracts. If the construction is not completed by the specified date, or if the builder otherwise fails to meet his contractual obligation, the letter of credit is a source of compensation for any resulting loss (ibid).

17/ Ibid., pp. 911-916.

18/ E.g., national and state banks in the United States.

19/ See: B. Kozolchyk, Commercial Letters of Credit in the Americas (1966), pp. 630-635. For this reason, bank guarantees in the United States usually take the form of an irrevocable letter of credit. Von Caemmerer, op.cit., p. 303, cites the following examples of a bid bond and a performance bond:

> "Irrevocable Credit No. 2107.
> For the account of X we hereby establish a Bid Bond for $ .... under the terms of Contract 107. This sum is available against your drafts on us if presented on or before March 1, 19 ... together with your statement that the accountee has not fulfilled your requirements.
> Y. Bank"
>
> "We hereby authorize you to value on us for the account of X up to an aggregate amount of $ .... available against a simple receipt accompanied by your statement that the Accountee has not complied with the terms of Contract No. 312."

a punitive character, they would not be enforceable in countries which invalidate contracts on this ground.

4. Guaranteeing payment of drafts by an aval

15. Guarantees may also be given by endorsement pour aval of drafts (bills of exchange and promissory notes). Under articles 32 and 77 of the 1930 Geneva Convention providing for a Uniform Law for Bills of Exchange and Promissory Notes, of 7 June 1930, the giver of an aval is bound in the same manner as the person for whom he has become guarantor and has, when he pays a bill of exchange or promissory note, the rights arising out of these instruments against the person guaranteed and against those who are liable to the latter on the bill or note.[20/]

5. Problems arising in the context of certain types of guarantee

16. Some problems arising in the context of bank guarantees are being considered by a Committee of the International Chamber of Commerce.[21/] That Committee identified three types of guarantee,[22/] used internationally, which give rise to major problems, namely: (i) tender guarantees (also referred to as tender or bid bonds which are sometimes required by the party inviting tenders as a safeguard against arbitrary withdrawing from the tender, or modifying its terms, after the tender is made and before the contract is allocated; (ii) performance guarantees (or bonds); and (iii) guarantees for repayment of advances made on account in respect of international supply and construction contracts.

20/ As regards the difficulties that have arisen in common law countries in connexion with devising a satisfactory method of guaranteeing payment of a bill or note by a third party somewhat akin to the aval of civil law, see Byles on Bills of Exchange, 22nd ed. (1965), pp. 133-137.

21/ The ICC's Commission on Banking Technique and Practice began consideration of certain forms of bank guarantees in 1964. The matter is now within the purview of a Joint Committee, consisting of members from the Commission on International Commercial Practice and members from the Commission on Banking Technique and Practice. The Joint Committee held its first meeting in September 1965.

22/ It seems, however, that the exact nature of these instruments, and therefore their terminology (bond, guarantee or indemnity) have not yet been determined.

17. Although the Committee's work is only in its initial stage, the problems arising in the context of these guarantees would appear to include the following: formalities to be observed, validity of promises for penalties, necessity for consideration,[23] capacity of the guarantor, and choice of law.

18. A special problem arises in connexion with the conditions under which the beneficiary would be entitled to claim under the guarantee. In order to minimize the risk of double performance by a party, it might be necessary to limit the danger inherent in the unilateral determination by the beneficiary of the contractor's performance, in particular in cases where the beneficiary, under the original contract, is entitled to recoupment for partial performance. In the same context, the rights of set-off and counter claim, to be raised by the guarantor, may be relevant.

19. It may be noted here that the Secretariat of the United Nations Economic Commission for Europe, in its observations on the study prepared by the International Chamber of Commerce on the subject of bankers' commercial credits,[24] suggested that a study be made of guarantees securing the adequate performance by contractors and suppliers of capital goods under international industrial contracts and contracts for public works. In the view of the ECE Secretariat, a legal solution to the problems arising in that context would facilitate international industrial co-operation.

23/ In some common law countries, a guarantee must be supported by a valuable consideration.

24/ A/CN.9/15.

B. SECURITIES

20. Payment of an indebtedness or performance of an obligation may also be secured by creating a security interest in property in favour of the creditor. National laws and commercial practice in this respect reveal the existence of a great variety of devices as well as substantial differences in their scope of application and legal effects.[25]

1. Use of securities in international sale transactions

21. In so far as the Secretariat has been able to assess, there is little or no evidence of security arrangements being used in international credit sale transactions where these transactions take place without the intervention of a financing institution.[26]

22. Some of the reasons that are advanced as an explanation for the absence of security arrangements in international sale transactions are the following:[27]

(i) the availability of other instruments for securing credit sales, e.g. letters of credit (for short term credits), guarantees and promissory notes;

25/ For the convenience of the Commission and as background material, the Secretariat has prepared a preliminary comparative analysis of these devices which will be issued as an addendum to this report (A/CN.9/20/Add.1).

26/ For example, there is an increasing use, by foreign exporters of capital goods to the Federal Republic of Germany and the Netherlands, of the conditional sale which is not subject in those countries to any formalities. See: U. Drobnig, Eigentumsvorbehalte bei Importlieferungen nach Deutschland, Rabels Zeitschrift (July 1963), pp. 450-472.

27/ Interviews.

(ii) the existence of national schemes for financing exports;[28/]

(iii) the diversity of laws relating to securities both as regards substance and procedural steps to be taken and the reluctance therefore of exporters to make use of devices with which they are not familiar;

(iv) the inadequacy, when the buyer is insolvent, of a security interest in the goods sold (in some countries the only security permitted by law) when the goods are of a kind which cannot easily be resold or shipped back, (e.g., power plants).

28/ These schemes cover various types of assistance to exporters, e.g. exporter credits, guarantees and insurance on export transactions, loans to foreign development banks for relending to foreign purchasers, commodity credits (e.g. aircraft credits) to foreign purchasers. Frequently, these guarantees and insurance policies also cover political risks.

In the following countries (the list not being necessarily exhaustive) there are schemes for the promotion of exports through financing: Australia (Export Payments Insurance Corporation), Austria (Oesterreichische Kontroll Bank A.G.); Belgium (Office National du Ducroire); Canada (Export Credit Insurance Corporation); Denmark (Eksportkreditradet); Finland (Export Guarantee Board); France (Compagnie Francaise d'Assurances pour le Commerce Extérieur, Societé Francaise d'Assurances pour Favoriser le Credit); Germany, Federal Republic of (Hermes Kredit Versicherungs A.G.); India (Export Credit and Guarantee Corporation); Israel (Israel Foreign Trade Risks Insurance Corporation, Ltd.); Italy (Instituto Nazionale delle Assicurazioni, Società Italiana Assicurazione Crediti); Netherlands (Nederlandsche Credietverzekering Maatschappij, N.V.); Norway (Garanti Institutet för Eksportkredit); Pakistan (Pakistan Insurance Corporation); South Africa (Credit Guarantee Insurance Corporation of Africa, Ltd.); Spain (Compania Española de Seguros de Credito y Caucion, Consorcio de Compensacion de Seguros); Sweden (Eksportkreditnämden); Switzerland (Geschaftstelle für die Exportrisikogarantie); United Kingdom (Export Credit Guarantee Department, London Trade Indemnity Company Ltd.); United States (Export Import Bank, Foreign Credit Insurance Association).

Most of the above corporations belong to the so-called "Berne Union", which meets periodically in Berne, Switzerland, to discuss credit problems and make gentlemen's agreements to prevent conflicts between countries interested in promoting exports.

2. Use of securities in international financing transactions

23. On the other hand, securities are widely used in the field of long-term financing of trade and investment.[29] Finance companies often require security for their loans, sometimes reinforced by a guarantee as an additional safeguard. Also, corporations often issue bonds on foreign markets that are secured by security devices recognized by the country of the issuer.

24. Among the various forms of securities, pledge of shares of corporate stock, treasury bonds or evidences of indebtedness received by the obligor from its own borrowers is by far the most important.[30] Pledge without dispossession of the borrower and mortgage of chattels, as well as mortgage of immovables (hypothèque), are also encountered.[31] Such securities are of course those permitted under the law of the place where the goods that are the object of the charge are situated (lex rei sitae, in practice usually the law of the country of the borrower) and must comply with the requirements of that law.

29/ A comprehensive analysis of the theory and practice in this field is contained in Delaume, op. cit. See in particular, part II, chap. V (pp. 215-251) on secured and guaranteed loans.

30/ Cf.: Delaume, op. cit., p. 254, referring, inter alia, to the Act of Pledge between the European Coal and Steel Community and the Bank for International Settlements which provides that evidences of indebtedness received by the ECSC from borrowing enterprises in representation of ECSC loans are held in pledge by the Bank.

31/ E.g. Loan Agreement between International Bank for Reconstruction and Development (IBRD) and the Tata Iron and Steel Company, Ltd. of 26 June 1956 (United Nations Treaty Series, vol. 30, p. 3), loan secured by a first specific mortgage upon the borrower's movable and immovable property and a first floating charge upon the borrower's undertaking and assets; Loan Agreement between the IBRD and Corporación de Fomento de la Producción and Compañía Manufacturera de Papeles y Cartones of 10 September 1953 (United Nations Treaty Series, vol. 188, p. 25), loan secured by a Hipoteca y Prenda Industrial (mortgage and pledge); idem, the Loan Agreement between the IBRD and Instituto Costarricense de Electricidad of 3 February 1961 (United Nations Treaty Series, vol. 414, p. 313), loan secured by a hipoteca y prenda industrial, both de primer grado; Loan Agreement between the IBRD and the Peruvian Corporation Limited of 13 March 1963 (United Nations Treaty Series, vol. 478, p. 245), loan secured by a hipoteca civil y prenda mercantil.

25. In certain types of contracts, the security interest of the lender consists in the assignment of income which the borrower will receive from third persons, e.g. sums due for the shipment of crude oil through a pipeline,[32] or for the supply of electric power.[33]

26. An interesting example of securing international transactions by a security interest based on title is provided by the European Company for the Financing of Railway Rolling Stock (Eurofima), a joint-stock company established by an international convention concluded at Berne on 20 October 1955.[34] The company's objects are "to obtain... for Railway Administrations which are its shareholders, as well as for other Railway Administrations or bodies, rolling stock of standard

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32/ E.g. the loans issued in France and the Netherlands in 1960 and in the United States in 1962 by the South European Pipeline Company (Societé du Pipe-line Sud-Européen), a limited liability stock corporation (societé anonyme), incorporated under French law, to finance the construction and operation of a pipeline from Lavéra (France) to Strasbourg (France) and Karlsruhe (Germany). In accordance with the Completion Agreement (Engagement de Bonne Fin) and the Throughput Agreement (Engagement de Transport), concluded between sixteen oil companies (which are the shareholders) and the Pipeline Company, the Company "shall have the possibility, to the extent necessary, of assigning in pledge as security for the... long-term loans, any sums which may be due to the Pipeline Company by each of the oil companies in carrying out this agreement". Under assignment agreements (contract de nantissement de créances) entered into with the representative of the French issue, the trustee of the Netherlands issue and the trustee of the United States issue, the Company shall assign all amounts payable to it under the Completion Agreement and the Throughput Agreement to the third party holder (tiers détenteur), designated in the agreements for the pro rata benefit of and distribution to the holders of specified long-term debt.

33/ E.g. Loan Agreement between the IBRD and Vorarlberger Illwerke A.G. of 14 June 1955 (United Nations Treaty Series, vol. 221, p. 375), loan secured by an assignment of rights to and claims for payments from two companies to which Vorarlberger Illwerke A.G. supplies electricity. This loan was also secured by a first mortgage.

34/ United Nations Treaty Series, vol. 378, p. 225. The Convention came into force on 22 July 1959. The following States have ratified or acceded: Australia, Belgium, Denmark, Federal Republic of Germany, France, Greece, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey and Yugoslavia.

type or performance necessary to their operations...".[35] Eurofima makes rolling stock available to railway administrations on hire-purchase (location-vente) contracts which shall be subject to Swiss law and shall provide that "the Company remains owner of that stock until such time as the purchase price is paid in full."[36] However, contracts of another type than hire-purchase may be concluded, provided that such contracts "give the Company guarantees which it considers to be equivalent"[37] and that "the Company shall remain owner of the whole stock until payment of the final instalment."[38] In addition to hire-purchase contracts, conditional sale agreements could therefore be stipulated, at least in those countries where the retention of ownership clause in a contract of sale can be successfully opposed to third creditors and the assignee in bankruptcy, as well as other devices under which the security of the creditor is based on title, such as the fiduciary transfer of ownership by way of security known in some of the Eurofima countries. In the event of default of a railway administration, Eurofima has the right "to demand in addition to damages for non-performance of the contract, the restitution of the stock in question, without having to refund the payments already made".[39] Since several of the Eurofima countries have, by law, prohibited certain contractual clauses favouring the seller in the event of default of the buyer, the Convention would appear to supersede domestic law in this respect in so far as transactions covered by the Convention are concerned.[40]

27. The above described security arrangements are supplemented by the undertaking of the contracting Governments to guarantee the obligations assumed by a railway administration of their countries towards Eurofima.[41]

35/ Article 3 of the Statutes.

36/ Part 3, chap. I, B, of the Basic Agreement of 30 September 1955.

37/ Ibid., part 3, chap. II.

38/ Ibid.

39/ Article 3 (a) of the Convention. See also part 3, chap. I, D, of the Basic Agreement.

40/ Thus, implicitly, Deleuze, op. cit., p. 241.

41/ Article 5 (a) of the Convention.

28. It is relevant to note that the Basic Agreement provides expressly that Eurofima may assign, transfer, or mortgage (constituer en gage), in whole or in part, the annual instalment payments due to it.[42] The Company may thus enter into assignment agreements with manufacturers who supply rolling stock to it on credit-terms, as security for payment of the full purchase price.

3. Rights in ships and aircraft

29. The only attempts at establishing international rules in the matter of securities have been made in regard to ships and aircraft which, owing to their essentially ambulatory character may be subject to different jurisdictions. This tends to create conflicts of laws which cannot satisfactorily be solved by the application of the lex rei sitae. The uncertainty in this respect,[43] which is also an obstacle to financing, has led to the adoption of three Conventions: (a) International Convention for the Unification of Certain Rules relating to Maritime Mortgages and Liens, signed at Brussels on 10 April 1926,[44] and revised at Brussels on 27 May 1967;[45] (b) Convention on the International Recognition of Rights in Aircraft, signed at Geneva on 19 June 1948,[46] and (c) Protocol No. 1 concerning Rights in rem in Inland Navigation Vessels, annexed to the Convention on the Registration of Inland Navigation Vessels, done at Geneva on 25 January 1965.[47]

42/ Part 3, chap. I, B.

43/ Courts have applied the lex rei sitae, the lex fori, the lex actus and the law of the port of registry.

44/ United Nations Treaty Series, vol. 120, p. 187. The Convention entered into force on 2 June 1931. The following States have ratified or acceded: Belgium, Brazil, Denmark, Finland, Hungary, Monaco, Norway, Poland, Portugal, Romania, Spain. Denmark withdrew on 1 March 1965, with effect as of 1 March 1966.

45/ This Convention replaces and abrogates the 1926 Convention "in respect of the relations between States which ratify or accede to" the 1967 Convention.

46/ United Nations Treaty Series, vol. 310, p. 151. The Convention came into force on 17 September 1953. The following States have ratified or acceded: Algeria, Argentina, Brazil, Chile, Cuba, Denmark, Ecuador, El Salvador, France, Germany (Federal Republic of), Haiti, Italy, Laos, Mali, Mauritania, Netherlands, Niger, Norway, Pakistan, Sweden, Switzerland, United States of America.

47/ The Protocol is not yet in force. It has been accepted by France and Switzerland.

30. A common characteristic of these Conventions is that the recognition and enforcement in Contracting States of security interests in sea-going vessels,[48] aircraft[49] or inland navigation vessels[50] is made conditional on these interests being registered in a public register.[51] They also provide rules on claims which give rise to liens[52] ranking ahead of the security interests referred to in

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48/ "Mortgages, hypothecations, and other similar charges upon vessels, duly effected in accordance with the law of the Contracting State to which the vessel belongs" (Article 1 of the Brussels Convention of 1926), "mortgages and hypothèques... effected... in accordance with the law of the State where the vessel is registered" (article 1 of the Brussels Convention of 1967).

49/ In principle any existing type of charge on aircraft, providing these "have been constituted in accordance with the law of the Contracting State in which the aircraft was registered as to nationality at the time of their constitution" (article I (i) of the Geneva Convention of 1948). Article I (i) enumerates four categories of rights in aircraft: rights of property, rights to acquire aircraft by purchase coupled with possession of the aircraft, rights to possession of aircraft under leases of six months or more, and mortgages, hypothèques and similar rights in aircraft which are contractually created as security for payment of an indebtedness.

50/ "Rights of ownership, usufruct or mortgage entered in a register of one of the Contracting Parties" (article 5 of Protocol No. 1 to the Geneva Convention of 1965).

51/ (a) "A public register either at the port of the vessel's registry or at a central office" (article 1 of the Brussels Convention of 1926). The Brussels Convention of 1967, however, did not retain the requirement of registration in a contracting flag-State: article 12 states that the provisions of the Convention "shall apply to all sea-going vessels registered in a Contracting State or in a non-Contracting State".

(b) "a public record of the Contracting State in which the aircraft is registered as to nationality" (article I (i) of the Geneva Convention of 1948).

(c) "a register of a Contracting Party" (article 2 of Protocol No. 1 to the Geneva Convention of 1965). The question of registration is regulated in the 1965 Convention.

52/ Maritime liens: article 2 of the Brussels Convention of 1926; article 4 of the Brussels Convention of 1967. Privileged claims on aircraft: article IV (1) of the Geneva Convention of 1948. Liens on island navigation vessels: article 11 of Protocol No. 1 to the Geneva Convention of 1965.

foot-notes 48, 49 and 50,[53] and on their priority as between themselves. Other provisions relate to attachment, forced sale and extinction of liens.

4. Negative-pledge clauses

31. It is of interest to note that lenders often seek to reinforce their protection against insolvency of the debtor by so-called negative-pledge or pari passu clauses. Under this clause the borrower agrees not to create any liens or charges on his property or assets in favour of other creditors unless, in doing so, the lien or charge secures, equally and wholly, the debt to the lender. While such a clause, being a contractual relationship between lender and borrower, can obviously not be considered as binding upon third parties in whose favour a charge on the borrower's assets is established, nevertheless when:

> "... the lenders maintain a continuing relationship with the borrower (as is the case of direct-loan contracts), negative-pledge clauses provide the lenders with a substantial assurance of equality of treatment" and "may operate as a check against excessive borrowing by enabling the lenders to insist on sharing in a particular security transaction thereby making potential creditors wary of lending." [54]

III. GENERAL CONSIDERATIONS

32. Although guarantees and securities basically serve an identical purpose, i.e. the protection of the creditor against default of the debtor, they nevertheless differ in at least one important aspect which in turn determines to a considerable degree their use in international commercial transactions.

33. From a legal point of view, several consequences flow from the different legal nature of guarantees (rights in personam) and securities (rights in rem). One consequence is that the autonomy of the parties operates effectively in respect of the former and only limitedly in respect of the latter.

53/ Article 3, para. 1, of the Brussels Convention of 1926 and article 5, para. 2, of the Brussels Convention of 1967; article IV (1) of the Geneva Convention of 1948; article 11 of Protocol No. 1 to the Geneva Convention.

54/ Delaume, op. cit., pp. 255-256.

34. In the case of a contract of guarantee, the guarantor's liability depends essentially on the terms of the contract. The accommodation of the contract by the parties to their particular needs, which is of common occurrence, as a general rule is fully effective. This fact, in itself, facilitates considerably the use of guarantees in international trade and explains the preference which it is given over securities.[55/]

35. Security agreements do not lend themselves to such accommodation. Firstly, what is stipulated by the parties, though valid as between themselves, will not necessarily be binding on third parties (e.g. other creditors, buyers) who may defeat the creditor's security interest. Secondly, the lex situs of the collateral may not recognize a security interest created elsewhere, on grounds of public policy (ordre public).

36. The autonomy of the parties also bears on the methods that might be employed to bring about solutions to existing problems. Thus, some of the problems that arise in the content of certain types of guarantee[56/] could conceivably be solved by the preparation of standard contract forms and/or general conditions.

37. The problems that arise in the context of securities appear to be of a different kind. Some of these, as advanced by commercial circles, have been indicated above.[57/] Moreover, the application of the lex situs as the law governing securities usually results in security agreements being concluded in conformity with the law of the situs of the collateral, so that conflict of laws problems will only arise when a chattel, encumbered by a security interest under the law of one situs, is subsequently transferred to another situs, e.g. when execution is levied upon it or when it is sold by the debtor to a bona fide purchaser. There are, however, not many reported cases in this area.[58/] The other set of problems, namely those that arise in the context of ambulatory chattels, has already been the subject of international conventions.[59/]

55/ See also para. 22 above.

56/ See paras. 16-18 above.

57/ See para. 22 above.

58/ Except where federal States are concerned.

59/ See para. 29 above.

38. Short of harmonizing the law of securities or establishing by international convention an international type of security that would be recognized and enforceable in contracting States,[60] it might be useful to consider ways and means to facilitate the wider use of securities in international trade transactions. Such a wider use might well further the conclusion of major international projects of the types that are designed to assist developing countries, e.g. so-called "turn key" contracts for the supply of industrial capacity under which the supplier agrees to build and equip a factory or plant, to hand it over in operational order and generally to supply the know-how, technical training and assistance necessary for its subsequent operation, or contracts for the building of power plants, ports, etc. These projects are normally so costly that they must inevitably be financed by long-term credit, and the debtor often anticipates paying for them out of the proceeds of the plant's operation.[61] Credit insurance, taken out by the supplier,[62] will not always dispose of the problem of financing: the availability and cost of such insurance may itself depend upon the extent to which the risk can be spread and reduced by the obtaining of security.

IV. PRELIMINARY CONCLUSIONS AND SUGGESTIONS

39. Against the background of the above observations, the following preliminary conclusions and suggestions are submitted for the Commission's consideration:

As to guarantees:

The Commission, taking into account the activities of other organizations concerned, might wish

(a) to identify the types of guarantees that are widely used internationally, including the problems to which they give rise, and to examine in the light of the available evidence by which methods existing problems could best be solved;

60/ This suggestion was made to the Secretariat by some of the persons whom it interviewed. The scope of application of an international security device, it was suggested, could conceivably be restricted to certain specific transactions and/or commodities that are of major interest in trade between capital exporting and capital importing countries.

61/ E.g. by assignment agreements. See foot-notes 32 and 33 above. See also para. 28 above.

62/ See foot-note 28 above.

(b) to make a study of conflict of laws problems, especially as regards formalities and the capacity of the parties;

(c) to make information on national laws relating to guarantees more readily available.

As to securities:

(a) In view of the fundamental differences that exist between the various security devices as to form, substance, legal effects and scope of application, and owing to the fact that in most countries the law of securities is to a considerable extent determined by the law of bankruptcy, rules of public policy (ordre public) and general legal principles that are peculiar to a given system of law, it would appear that, at this stage, there are particular difficulties to unification or harmonization of law as a method for bringing about solutions to existing problems or for facilitating a wider use of security arrangements in international commercial transactions.

(b) In order to facilitate the wider use of securities in international trade transactions, in particular where these concern major international projects, the Commission might wish to make information on national laws relating to securities (formalities, legal effects, enforcement, etc.) more readily available, e.g. by compiling or promoting the compilation of, information about national laws on the subject.

(c) As a long-term project, in respect of which the information referred to in (b) would provide a valuable basis, the Commission might wish to consider:

(i) whether certain anomalies in the law of securities could be removed and procedures simplified with a view to stimulating international trade;

(ii) the desirability and feasibility of developing an internationally recognized and enforceable security device.
