

## Personal securities – a different approach the regulation of DCFR

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### **Abstract**

*Personal securities are a guarantee instrument, particularly attractive for creditors, reason why they play an important role in practice, especially in trade. Their regulatory way in European legislation, however, is essentially different, being one of the least uniform subjects at European level. The form, let's say the classical one, of personal security is the fidejussio, known since the Roman law as “fideiussio”, a legal mechanism which experienced a relatively uniform regulation at level European, precisely due to the common source of Roman law. Other forms of personal securities such as the independent warranties are a modern phenomenon, recently introduced in member States legislations and their regulatory mode varies from one state to another. Based on the existing regulations in the Member States, DCFR – the model of a European Civil Code regulates personal securities, but in its own way, different from that existing in internal regulations. DCFR classifies personal securities, in a simple manner, into two broad categories: dependent personal securities and independent personal securities. The European Civil Code draft thus introduces a new terminology which is not found in any European legislation, a solution that has not been used in any other model regulations. As a general rule, the DCFR authors chose to use terms used in national laws, thus avoiding to create a new terminology, without internal equivalent. This paper proposes to make a short presentation and also an analysis of this proposed regulation, which has, at least in terminology, a different approach.*

**Keywords:** *personal securities, European legislation, uniformization.*

### **Chapter 1 The notion of personal dependent security and independent personal security**

Personal securities are regulated in Book IV of DCFR, called Specific contracts and the rights and obligations arising from them, Part G. It should be noted that, in the view of DCFR, personal securities fall under special contracts, unlike our civil code where personal securities are regulated separately, in Title X of Book V dedicated to obligations matter. The regulation of DCFR is divided into four chapters, the first chapter providing definitions and common rules for all personal securities, followed by Chapter 2 dedicated to dependent personal securities, Chapter 3 dedicated to independent personal securities and Chapter 4 providing special rules for the situation in which, within the legal relationship, one party is a consumer as defined by the DCFR.

DCFR creates a clear distinction between dependent personal securities and independent personal guarantees, this distinction being precisely the DCFR innovation, at least in terminology. The terms of dependent personal security and independent personal security are not used in any of the domestic laws of European countries. Different types of securities known and regulated in the national laws of European states, fall under one of the two categories following a key criterion: the close connection or, in other words, the dependence on major aspects of the original debt or the absence of a close link/ independence from the debt underlying the personal security.

In article IV. G – 1:101 Definitions, letter a) “a dependent personal security” is defined as “an obligation by a security provider which is assumed in favour of a creditor in order to secure a right to performance of a present or future obligation of the debtor owed to the creditor and performance of which is due only if, and to extent that, performance of the latter obligation is due.” The “independent personal security” is defined as “an obligation by a security provider which is assumed in favour of a creditor for the purposes of security and which is expressly or impliedly declared not to depend upon another person’s obligation owed to the creditor” ( IV. G-1:101)

It should be also noted that DCFR editors give great importance to the accuracy of the terminology used, this sanctioning some expressions encountered in various European internal regulations that are not rigorously accurate. In the case of securities, DCFR editors consider accurate the use of the concept of “secured right” rather than “secured obligation.” Although a secured obligation is most frequently mentioned, it is creditor’s right is actually the one that is guaranteed, with the security affecting the right, not the obligation. The debtor’s obligation remains the same and the creditor’s right is the one who benefits or not from an additional security. DCFR editors consider accurate that, when we speak of a personal security, we talk about “as an obligation whose right to enforcement is guaranteed.”

### ***1.1 Dependent personal securities***

As previously stated, the term of dependent personal security is not used in any legal system in Europe, the types of dependent personal securities in these systems being regulated under a different name, such as: security, bail, fidejussion. By way of

example, the term of cautionnement is used in France and a part of Belgium; in Italy, Portugal and Spain where Roman origin of personal securities is more obvious, the term of fideiussione is used in Italy, fianca in Portugal and fianza in Spain. In all these countries, the independent personal guarantees securities have another name, respectively independent warranties. A similar terminology is also used by our Civil Code under Article 2279, the personal securities being the fidejussion and the independent warranties. A distinctive terminology is used in all other European countries. The lack of a clear and universally accepted terminology is the reason why the DCFR editors opted to create its own distinct terminology.

The form of the dependent security, as regulated by the DCFR, is known in all Member States as being the usual and classical form, by which a third party undertakes to enforce the debt of another person, by assuming a new obligation to the creditor.

The dependent personal security develops a triangular relationship between the creditor, the principal debtor and the person who secures the obligation (security provider) to the principal debtor. However, only two parties are most frequently involved in the contractual relationship generating the personal security: the principal debtor and the person guaranteeing the fulfilment of its obligation. The contract may be bilateral in nature, especially if the person guaranteeing the fulfilment of the obligation is a professional, whether it is a banking institution or an insurance company that charges a fee for assuming the guarantee, or it is a unilateral agreement generating an obligation only to the person who guarantees the fulfilment of the obligation, especially when the latter is a natural person who does not collect any payment for the guarantee. The primary obligation guaranteed can be of any kind, but most frequently it is an obligation to pay an amount of money, whether it is the return of a loan, payment of a price or a rent or payment of damages. The primary obligation may exist at the moment of setting a personal security or may guarantee a future obligation, as in the case of guaranteeing the payment of damages for failure to fulfil an obligation undertaken through a contract between the creditor and the principal debtor. However, the primary obligation may be conventional or an obligation imposed by law.

The main feature of dependent personal securities is the close connection to the primary obligation, this type of securities appearing as an accessory of this one. The

relationship of dependence between the personal security and the primary obligation should not be sought in the contract concluded between the debtor and the person who guarantees the fulfilment of the obligation but in terms of the contract or the legal act generating the primary obligation. The dependent personal security is characterized by the fact that, in almost all aspects, depends on the obligation of the principal debtor. Basically, this character dependent to the primary obligation is supposed to depend on the validity, the terms and the content of the primary obligation. For example, in a situation where the contract that gave rise to the obligation of the principal debtor is declared invalid, the dependent personal security will be void. In addition, the person who guarantees the fulfilment of the obligation can oppose to the creditor all the exceptions and all the defences that the principal debtor can also invoke.

The dependence of such a type of personal security to the obligation assumed by the principal debtor knows one exception: the principal debtor's insolvency. All defences that can be invoked by the principal debtor under a special protection granted by the insolvency law cannot be of benefit to the person who guarantees the fulfilment of the obligation. Therefore, the insolvency of the principal debtor has no effect on personal security, a contrary approach being ineffective for the fundamental purpose and function of such a security.

The dependence principle on a personal security is also recognized in practice of CJEU (Court of Justice of the European Union), which ruled that the fidejussor's obligation can be enforced only at the time when the primary obligation has fallen due and its content cannot exceed the content of the obligation assumed by the debtor (*Bayerische Hypotheken – und Wechselbank AG v. Dietzinger*, case C- 45/96, 1998, ECR 1998 I 1199).

### ***1.2 Independent personal securities***

The independent personal securities are a creation of trade practice in the last century, gradually gaining a legal regulation in most European countries, based on the existing practice in every state. Some states, such as Germany, have introduced special regulations in the Civil Code on independent personal securities, motivated by the fact that this type of guaranteeing has a variety of forms, but the creation of such securities is perfectly valid. In terms of terminology, several European countries use the term of

independent security or an equivalent of that, such as in Italy, Portugal, Spain, Belgium and Luxembourg where, in order to define such a personal security, words like independent, abstract or autonomous are used. In our civil code, the same terminology was introduced, the autonomous securities being covered in Chapter III of Title X, in two forms: the letter of guarantee and letter of comfort.

The obligations assumed by an independent personal security varies depending on the will of the parties, expressed in the contract giving rise to such security, but also according to the provisions of laws existing in each state. The internal regulations in the European states on independent personal securities have many differences, but there is a common characteristic in all cases: the obligation assumed by the person guaranteeing the fulfilment of an obligation to the creditor will cover against any losses incurred by the creditor, without having the same content as the principal debtor's obligation. Therefore, an independent personal security is characterized by independence from any other contract, even to the contract concluded between the creditor and the principal debtor.

For such personal securities, DCFR imposes a special rule: the independent character to be explicitly or implicitly declared. DCFR provides the presumed independent character of a personal security in Article IV.G – 2:101; the creditor must produce the contrary evidence. Stating the independent character of a personal security is usually found in the very title of such a document, most commonly called independent security. A personal security may be implicitly considered independent if its content does not refer to any obligation of which fulfilling guarantees, such an omission being considered as an implicit declaration of independence. The reference in the contract giving rise to an independent personal security of a transaction under consideration in its constitution is not likely to affect the independence of such security. In most cases, an independent personal security envisages another transaction of the creditor, in order to specify the event which gives the creditor the right to require the execution of the security. Such a general provision on an obligation underlying the independent personal security does not affect the independent character thereof, critical in determining whether such a security being the creditor's right to request the execution of the

personal security, independent of the performance of the obligation by the principal debtor.

For banks or insurance companies issuing such securities as part of their current activity, independent personal securities bring economic advantages compared to dependent personal securities. In the case of these independent personal securities, the risk assumed can be calculated, this underlying the rates they will charge for taking such a risk. Instead, dependent personal guarantees are advantageous as they allow the person who secures the obligation to oppose to the creditor the exceptions and defences based on pre-existing report of obligations, but such a process involves additional costs and time, without guaranteeing the success. At the same time, the possibility to execute an independent security exempts the creditor to prove the debtor's fault in fulfilment of the obligations. While all these characteristics of the independent personal securities are beneficial for professionals issuing such securities, as well as for the creditor, for the principal debtor, the independent character of the primary obligation assumed is a disadvantage. In order to prevent abuse or fraudulent conduct of the creditor, manifested by the request to execute the personal security, DCFR introduced special regulations in Article IV.G – 3:104 and IV.G – 3:105. Similar regulations are found in our Civil Code, where Article 2321, paragraph 3, which governs the letter of guarantee, provides that the issuer of the letter of guarantee cannot be liable to pay in case of abuse or conspicuous fraud.

## **Chapter 2. Different approaches on personal securities in DCFR and our Civil Code**

As stated above, our civil code regulates personal securities in Title X of Book V – On obligations. The title is divided into three chapters, Chapter I – General Provisions, contains one article, 2280, which describes the types of personal securities, Chapter II covers the first type of personal security – the fidejussion, respectively, and Chapter III regulates the autonomous securities which includes the letter of guarantee and letter of comfort. We should mention that the autonomous types of securities were not covered in the old civil code, even though they were used in practice, especially in banking practice.

DCFR classifies personal securities in dependent personal securities and independent personal securities, with special regulations for the two types of securities and general rules applicable to all types of securities.

The two regulations are different in almost every aspect, but we will limit ourselves to present the most important differences. Firstly, according to DCFR, the personal security represented by the comfort letter does not automatically constitute an independent or autonomous security, as considered in our civil code. According to DCFR, the comfort letter is presumed to be a dependent personal security, unless there is an explicit or implicit statement showing the opposite. The liability of issuer depends on the concrete commitment concluded between parties and the independent nature of this type of security is treated differently in European countries. Our Civil Code regulates the comfort letter within the Chapter on autonomous and personal securities, and the legal text unequivocally reveals the independent nature thereof to the primary obligation for which fulfillment was created. According to paragraph 1 of Article 2322, the comfort letter is that irrevocable and autonomous commitment by which the issuer assumes an obligation to do or not do, in order to support another person called debtor, in the execution of his/her obligations to a creditor. The issuer will not be able to oppose to the creditor any defense or exception deriving from the obligation report concluded between the creditor and the debtor.

Another major difference between the two regulation is that DCFR has a versatile form which can be applied to more guarantee instruments currently used in trade, especially in international trade relations, such as if the credit letters of stand-by type. The credit letters of stand-by type are similar to independent personal securities, as they are an instrument mainly used in international trade and do not have their own regulation in most European countries. Most commonly, this type of guarantee instrument, internationally recognized regulations are applicable, regulations such as ISP98 issued by the International Chamber of Commerce in Paris or the UN Convention of 1995 on Independent Securities. On the other hand, our Civil Code in art. 2279 states that besides fidejussion and autonomous securities regulated in the code, there can also be other personal securities expressly provided by law. Therefore, the Civil Code does not contain limiting rules, thus leaving the possibility to create other types of

personal securities, but in the absence of their special legal regulation, such instruments remain outside the actual legal framework.

### **Conclusions**

Introducing the autonomous securities in the civil code is welcome, given that such instruments were already being used in practice, this being an alignment to the realities of economic and commercial practice.

However, compared to DCFR regulation, our Civil Code is limitative in terms of autonomous securities. DCFR addresses general rules based on the differentiation of personal securities in two major types: dependent personal securities and independent personal securities. DCFR rather not uses their name when it covers a type of personal security; the starting point of regulation is their characteristics. Therefore, according to the DCFR regulation, the two main categories may include a variety of types of securities, whether it is the classical fidejussion, the bank grant, the guarantee letter, the comfort letter or stand-by credit letter. The multitude problem of personal securities was thus removed, securities which may be encountered in practice and for which the legislator ought to define and create its own definitions and distinct rules.

However, the new approach proposed by DCFR has a downside: the legal text accessibility to people without specialist knowledge. Thus, for practical application of the DCFR text, the first step to do is classifying the personal security in one of the two board categories, based on its essential dependence or independence from the primary obligation, and this is not easily to achieve for those who are not familiar with the specific concepts. In this respect, our Civil Code text is more practical, the regulation on personal securities is based on the concrete form they may take, is also accessible to those without the specialist knowledge but interested in finding out the provisions applicable to a specific type of personal security in which they may punctually be interested. Nevertheless, we consider this a minor drawback compared to the advantage created by the flexibility of rules on personal securities.

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